THE IMPACTS OF GATS:
A CASE STUDY OF TOURISM DEVELOPMENT
IN EGYPT

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VOLUME I

بسم الله الرحمن الرحيم

In The Name of Allah The Kindest the Most Merciful

To my Husband,
for his love, care and support
&
My children,
Who I love and care about

ABSTRACT

Economic activity is becoming not only more internationalised, but, more significantly, it is becoming increasingly globalised. Globalisation is always regarded as a product of the liberalisation that has been the hallmark of economic policy throughout the world during the past two decades. Globalisation and liberalisation feed off each other and the former has certainly set in motion forces working to accelerate liberalisation. Both globalisation and liberalisation have increased the potential for international trade to further establish itself as an engine of growth and an important mechanism for integrating countries into the global economy.

Tourism is not only the dominant service in world trade, it has also become one of the most important industries in the world and its economic impacts are vital for many countries. The tourism industry has long supported the idea of services agreements and has become a major force of the globalisation of international trade, particularly in services. The significance of tourism as a source of income and employment and as a major factor in the balance of payments for many countries has been attracting increasing attention. Governments, private sector entities, regional and local authorities, and others with an interest in international trade and economic development have recognised the role to be played by tourism. If the barriers to worldwide travel were eliminated or reduced substantially, international trade in tourism services is likely to increase dramatically.

The globalisation of production and the liberalisation of trade offer opportunities for all countries and enable developing countries to play a more active role in the world economy. However, these newfound opportunities do not come without a price and this is to be found in the increasing complexity associated with interdependence including instability and marginalisation. Therefore, the net result is one of trade off between economic gains and costs.

The World Trade Organisation (WTO) is the only international body dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the trading nations of the world. Its main functions, as defined in article III of the Agreement, are to facilitate the implementation, administration and operation of the Uruguay Round Agreements (GATT, GATS, TRIPS, act) and to provide a forum for negotiations among members. The WTO's overriding objective is to help trade flow smoothly, freely, fairly and predictably.

There is no doubt that the WTO and the GATS have assisted the growth of international trade in goods and services. However, the success of such instruments relies upon markets behaving in a Ricardian manner incorporating the fluidity and transparency that form the substance of those markets.

The purpose of this research is, through analysis, to gain insight into the impacts of liberalisation brought about by the GATS on tourism development in Egypt and to explore stakeholders' perceptions of tourism liberalisation. This research aims to analyse the terms, codes and practice of the WTO and the GATS and their implications for the tourism sector. This examination is intended to enhance understanding of how the General Agreement is intended to work and how it may help governments exploit the system to their own advantage, especially in the developing countries.

The research has five broad objectives. The first is to evaluate the level of openness in Egypt's trade in services in general and tourism in particular. The second is to examine and display the main features of Egypt's GATS commitments. Third, is to explore whether the macroeconomic environment offers the necessary conditions for tourism liberalisation and for private business development (foreign and local alike). Fourth, to determine whether the institutional climate is amenable to the growth and competitiveness of private firms. Finally, to evaluate the potential impacts of GATS on tourism development in Egypt. This research also has the objective of developing policy options that embrace and reflect all the major relevant concepts of tourism liberalisation.

There are likely to be transitional impacts of trade liberalisation through WTO and GATS. The World Bank (2000) states that globalisation and liberalisation do not benefit everyone equally. Developing countries and the least developing countries are always the least able to take advantage of the opportunities that GATS presents, and globalisation and liberalisation may lead to an increase in inequality in these countries.

The future of tourism development in Egypt, as well as the ability of Egypt to integrate successfully into the global trading system will depend upon its ability to strengthen its capacity to produce internationally competitive services and upon the extent of liberalisation in the services sectors in general and the tourism sector in particular.

In today's globalised market, a country competes with every other destination in the type and price of tourism it offers. The main findings of this research indicate that if Egypt is to be successful in competing in the international tourism market, standards of excellence must be introduced for its products, particularly for infrastructure and accommodation and services. Management and administration of the sector must improve. Governments must shift to policies that encourage tourism. For example, the sector cannot develop without improvements in public health and personal safety in tourist areas. Air policies that support ease of access and traffic growth are also critical. Governments must also invest in expanded human resource development and institutional capacity building, and improve environmental mitigation and protection. The value to the final consumer is determined by the quality of all these components of the tourism package.

Given its cross-sectoral nature, tourism will only develop in a sustainable manner if it is integrated into the country's overall policies and economic and physical planning mechanisms and if linkages are created across the many sectors spanned by tourism. Partial policy measures will be inadequate to address vested interests, underlying economic relationships and generic social or physical constraints.

The creation of highly competitive products through good management of natural and built tourist assets is most likely to convince the international industry to promote one country over another in the global market place. Countries can influence these external industry managers through an effective and continuing promotion and marketing campaign, but will be successful only if there is a high-quality, competitive product to sell that competes in value and not just price.

It is hoped that these findings, which offer an understanding of the impacts of GATS and WTO on tourism development, may help address national and regional tourism development policy-making and strategies in developing countries.

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LIST OF ABBREVIATIONS

ABTA	Association of British Travel Agents
AFT	Agencé Financieré Touristique
AFTA	Asian Free Trade Area
ANOVA	One Way Analysis of Variance
APEC	Asian-Pacific Economic Co-operation
ARENTO	Arab Republic of Egypt National Telecommunication Organisation
Article IV	Increasing Participation of Developing Countries
Article IX	Business Practice
Article XIX	Negotiation of Specific Commitments
Article XV	Subsidies
Article XVI	Market Access
Article XVII	National Treatment
ASEAN	Association of South East Asian Nations
ASTA	American Society of Travel Agents
BIT	Bilateral Investment Treaty
BMI	Business Monitor International
BOOT	Build-Own-Operate-Transfer
CAB	Civil Aeronautics Board
CAPAS	Co-ordinated African Programme of Assistance on Services
CAPMAS	Central Agency for Public Mobilisation And Statistics
CBE	Central Bank of Egypt
CET	Customs Egyptian Tariffs
CMEA	Council of Mutual Economic Assistance
COMESA	Common Market of Eastern and Southern Africa
CPC	Central Product Classification
CPs	Contracting Parties
CRS	Computer Reservation System
CTE	Committee on Trade and Environment
DC	Developing Countries

DMEs	Development Market Economies
DSM	Dispute Settlement Mechanism
DSU	Dispute Settlement Unite
EAH	Environment and Artistic or Historic
EBA	Egyptian Businessmen's Association
ECES	Egyptian Centre for Economic Studies
EEC	European Economic Community
EFTA	European Free Trade Association
EGOTH	Egyptian General Organisation for Tourism and Hotel
EGPC	Egyptian General Petroleum Company
EIU	Economist Intelligence Unite
ENTs	Economic Needs Tests
ERSP	Electronic Reservation Services Providers
EU	European Unions Community
FAA	The US Federal Aviation Administration
FDI	Foreign Direct Investment
FEI	Federation of Egyptian Industries
GAFI	General Authority for Foreign Investment and Free Zones
GAFTA	General Arab Free Trade Area
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GDSs	General Distribution Systems
GNP	Gross National Product
GNY	Gross National Income
GSP	Generalised System of Preferences
GSTP	Global System of Trade Preferences
HCHTC	Holding Company for Housing, Tourism and Cinema
HMERC	High Ministerial Economic Reform Committee
IATA	International Air Transport Association
IBRD	International Bank for Reconstruction and Development
ICAO	International Civil Aviation Organisation
ICRG	International Country Risk Guide

IIE	Institute for International Economics
ILO	International Labour Organisation
IMF	International Monetary Fund
IPO	Initial Public Offerings
IPR	Intellectual Property Rights
ISO	International Organisation for Standardisation
IT	Inclusive Tour
ITA	Information Technology Agreement
ITO	International Trade Organisation
LAFTA	Latin America Free Trade Area
LDCs	Less Developed Countries
MENA	Middle East and North Africa
MFA	Multi-Fibre Arrangement
MFN	Most Favourite Nation
MIGA	Multilateral Investment Guarantee Agency
MRAs	National Mutual Recognition Agreements
MRO	Maintenance, Repair and Overhaul
MTN	Multilateral Trade Negotiation
MTO	Ministry of Tourism
NAFTA	North America Free Trade Agreement
NDP	National Democratic Party
NGOs	Non- Governmental Organisations
NIP	National Institute for Planning
NMC	National Marketing Company
NOC	No Objection Certificate
NSSP	National Vocational Skills Standards and Certification System Project
NTBs	Non-Tariff Barriers
OECD	Organisation for Economic Co-operation and Development
OEEC	Organisation for European Economic Co-operation
ONTT	Office National du Tourism Tunisien
OPEC	Organisation of Petroleum Exporting Countries
PA	People Assembly

PEO	Public Enterprise Office
PSI	Pre-Shipment Inspection
REER	Real Effective Exchange Rate
RTA	Regional Trading Arrangements
SICTA	Standard International Classification of Tourism Activities
SMEs	Small and Micro Enterprises
SNA	System of National Account
SPSS	Statistical Package for the Social Science
STA	State Tourism Administration
TDA	Tourism Development Authority
TMB	Textiles Monitoring Body
TNC	Trade Negotiations Committee
TOPS	Thomson Online Programme System
TRAIPs	Trade Related Aspects of Intellectual Property Rights
TRIMs	Trade Related Investment Measures
TRIPs	Trade Related Intellectual Property Issues
TSA	Tourism Satellite Account
TTRS	Tourism and Travel Related Services
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
USA	United States of America
USAID	United States Aid
USSR	Union of Socialist Soviet Republics
VAT	Value Added Tax
VFR	Visit Friends and Families
VTCs	Vocational Training Centres
WTO	World Trade Organisation
WTO/MOT	World Tourism Organisation
WTTC	World Travel and Tourism Council

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CHAPTER ONE

GENERAL INTRODUCTION

1.1 INTRODUCTION

Economic activity is becoming not only more internationalised, but, more significantly, it is becoming increasingly globalised. Globalisation is always regarded as the product of the liberalisation that has been the hallmark of economic policy throughout the world during the past two decades. It has also set in motion forces working to accelerate liberalisation. One of the distinguishing features of trade at the end of the 20^{th} century and the emergence of the new millennium is the expansion of regional trade agreements and the multilateral agreements. The internationalisation of services is at the very core of today's economic globalisation. Tourism is not only the dominant service in world trade, it has also become one of the most important industries in the world and its economic impacts are vital for many countries. The tourism industry has long supported the idea of services agreements and has become a major force of the globalisation of international trade, particularly in services. There is no doubt that the WTO and the GATS have assisted the growth of international trade in goods and services. However, the success of such instruments relies upon markets behaving in a Ricardian manner incorporating the fluidity and transparency that form the substance of those markets.

The purpose of this research is, through analysis, to gain insight into the impacts of liberalisation brought about by the GATS on tourism development in Egypt and to explore stakeholders' perceptions of tourism liberalisation. The research has five broad objectives. The first is to evaluate the level of openness in Egypt's trade in services in general and tourism in particular. The second is to examine and display the main features of Egypt's GATS commitments. Third, is to explore whether the macroeconomic environment offers the necessary conditions for tourism liberalisation and for private business development (foreign and local alike). Fourth, to determine whether the institutional climate is amenable to the growth and competitiveness of private firms. Finally, to evaluate the potential impacts of GATS on tourism development in Egypt. This research also has the objective of developing policy options that embrace and reflect all the major relevant concepts of tourism liberalisation.

There are essentially four basic areas of study. First, the study undertakes a comprehensive review and description of international trade theory and policy in relation to tourism development and discusses the advantages and the disadvantages of liberalisation for developing countries in general and Egypt in particular. Second, it makes a comprehensive review of the liberalisation of the world trading system in relation to the tourism industry and the level of liberalisation (regional, sub-regional and multilateral level). This review includes the World Trade Organisation (WTO) and the General Agreement on Trade in Services (GATS). It also discuses the implementation of GATS with respect to the tourism industry. The specific issues relating to the impacts of liberalisation on developing countries was also considered. Third, an analysis of the impact and repercussions of GATS on tourism development in Egypt is explored. A discussion on the role of tourism in the Egyptian economy and the level of liberalisation through GATS commitments is also presented. Finally, the thesis explores the tourism policies in Egypt with respect to their main characteristics and vulnerabilities to liberalisation after the GATS.

The research attempts a comprehensive analysis of stakeholders groups' perceptions of tourism liberalisation and explores the impacts of GATS. The research represents the first of its kind to offer a detailed description and analysis of tourism liberalisation and the GATS in Egypt. The study used qualitative and quantitative data to analyse the impacts of GATS on tourism development in Egypt.

1.2 BACKGROUND

1.2.1 IDENTIFICATION OF COMPARATIVE ADVANTAGE AND COMPETITIVE STRATEGIES

International trade has long been recognised as an essential ingredient for economic development, growth and the well being of a nation. Trade has, since time immemorial, linked the world's major economies, but dramatic improvements in transportation, telecommunications and international relations have pulled nations ever closer together. From an economic perspective the world is now characterised by the degree of its interdependence (Parker, 1998). This interdependence is not a new phenomenon. For centuries the world economy has become increasingly integrated. In the past quarter-century, the pace of integration has accelerated, and the implications of interdependence have become more pronounced. In part, the increased level of interdependence is reflected in the number and duration of international economic conflicts. In turn the extent of economic gains and losses to the parties affected and the inadequacy of policy instruments to resolve conflicts also suggest the predominance of international exchange.

In many economies, the international travel and tourism industry has already been recognised as a major area of export activity that draws on the resources of those economies and affects their nature and development. International tourism constitutes one of the most significant global trade flows. Additionally, the increasing share of services in international trade has focused attention on tourism as a major contributor to many countries' balance of payments. A further characteristic carried forward into the new century is the recognition that tourism has become a major component of economic strategy.

It is important to realise that international tourism is a major force for the globalisation of international trade, particularly in services (Fletcher et al, 1999). The significance of tourism as a source of income and employment and as a major factor in the balance of payments for many countries has been attracting increasing attention. Governments, private sector entities, regional and local authorities, and others with an interest in international trade and economic development have recognised the role to be played by tourism. If the barriers to worldwide travel were eliminated or reduced substantially, international trade in tourism services is likely to increase dramatically.

According to Dicken (1992), economic activity is becoming not only more internationalised, but, more significantly, it is becoming increasingly globalised. UNCTAD (1999e) suggests that globalisation has dominated the characteristics of world trade and is the product of the liberalisation. Globalisation and liberalisation feed off each other and the former has certainly set in motion forces working to accelerate liberalisation. Both globalisation and liberalisation have increased the potential for international trade to further establish itself as an engine of growth and an important mechanism for integrating countries into the global economy.

Technological advances and the rapid liberalisation and deregulation of trade and market flows at the national and international levels have fuelled this globalisation process. For more than a century, the driving force behind globalisation has been the expansion of trade in goods and services. This process is likely to continue well into the 21st century where trade in general, and services in particular, will continue to drive global integration, especially among developing countries.

The globalisation of production and the liberalisation of trade offer opportunities for all countries and enable developing countries to play a more active role in the world economy. However, these newfound opportunities do not come without a price and this is to be found in the increasing complexity associated with interdependence including instability and marginalisation. Therefore, the net result is one of trade off between economic gains and costs.

Technological advances, increased mobility of production factors and regional and international arrangements have opened the door to the prospect of considerable gains in productivity and wealth creation. Some developing countries are already reaping the benefits whereas others are not yet able to fully exploit these opportunities. In principle all countries should benefit if their governments are able to create the necessary conditions for promoting sustainable development, economic growth and stability.

1.2.2 WTO AND THE WORLD TRADING SYSTEM

Half of a century ago, the world emerged from the ravages of the Second World War. The challenge at that time was to rebuild economic stability from the ashes of disorder and in the face of massive dislocation. There was also a dire need to restore a sense of world community and to establish the foundations for future growth and prosperity. The architects of the new system had to build on multiple fronts, simultaneously, from the first cornerstone, and they did so with vision and far-sightedness. The latter half of the 1940s was not just about the end of the most destructive war ever waged, it was also about the curbing of destructive economic nationalism and the search for a new global order.

Today we face a new kind of world and a new set of challenges. The end of the Cold War and the collapse of command and control economies, the dramatic rise of many developing countries, and the massive increase in trade and investment flows around the globe have greatly expanded the frontiers of the multilateral trading system, and tested its ability to manage an economy of global dimensions. The creation of the WTO in January 1995 was an icon for a more universal economic system.

The World Trade Organisation (WTO) is the only international body dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the trading nations of the world. Its main functions, as defined in article III of the Agreement, are to facilitate the implementation, administration and operation of the Uruguay Round Agreements (GATT, GATS, TRIPS, act) and to provide a forum for negotiations among members. The WTO's overriding objective is to help trade flow smoothly, freely, fairly and predictably. It does this by:

- Administering trade agreements;
- Acting as a forum for trade negotiations;
- Settling trade policies;
- Assisting developing countries in trade policy issues through the provision of technical assistance and training programmes;
- Co-operation with other international organisations.

Although there was a hesitant start, two basic beliefs, as vital today as they were in the late 1940s, have underpinned the system's success over the second half of this century (World Bank, 1999b). The first belief is that an open international trading system is able to promote economic prosperity and can provide a cornerstone for the foundation of a new political and security order. The architects of the post-war system agreed that the only route to economic reconstruction and recovery lay in progress towards an open market and liberalised trade. Experience over the past 50 years may have proven them right. The second belief is that the stability and predictability of international trade can only be secured through a mutually agreed system of rules that are binding on all member governments and enforceable through dispute settlement.

The WTO multilateral trading system has played an important role in promoting growth and new opportunities in the post-war period and has evolved in response to, as well as being a part of, the forces of globalisation. The original liberalisation process was found lacking with respect to its primary concern over the removal of tariffs and quantitative trade restrictions on goods at the border. Its new, broader horizons focus more closely on an ever-growing range of policy measures affecting the terms and conditions of market access, such as standards and regulations, subsidy practices, trade in services, and intellectual property protection. Policy areas like investment and competition are receiving more attention along with various aspects of labour policy.

However, success in free trade cannot be measured within a static framework. The ability to compete well in particular products or service markets can change rapidly in response to technological and political developments. Such shifts in competitiveness are not confined to companies and can involve entire economies. However, the WTO would argue (1998d) that, with the stimulus of an open economy, a country could move on to become competitive in a wider range of goods or services. This is normally a gradual process. When the trading system is allowed to operate without the pressure of protectionism, firms are encouraged to adapt gradually and in a relatively painless way. In fact, the centrepiece and guiding belief of the rules-based system is that exclusionary deals and preferential blocs helped fuel the inter-war rivalries, insecurities and conflicts that drove the international community into another world war. The non-discrimination principle has been the key to the system's stability in subsequent years.

Ferndez (1997) and Foroutan (1998) go further than this by asserting that the non-discrimination principle plays an important economic role. They argue that it is an efficiency principle, both in the sense of ensuring access to low-cost supplies and in allowing producers to sell in foreign markets without a policy-imposed disadvantage relative to other suppliers. Similarly, in a non-discriminatory policy environment, customers can choose freely from among alternative foreign sources of supply. In a world of differentiated, discriminatory trade regimes, doing business across frontiers becomes more complex and time-consuming, implying additional costs for enterprises and impaired competitiveness. Counter to this, the development of technologies, new distribution channels and communications have made this complex process easier to undertake. For both political and economic reasons, the non-discrimination principle has served countries well over the last 50 years, be they large or small, developed or developing.

For five decades, the GATT and the WTO stood for trade liberalisation. The willingness of governments to open markets progressively to foreign competition, and to keep them open, has been a key element in the realisation of the benefits of globalisation. Liberalisation is a long-term process, whose greatest benefits do not accrue immediately but over time, through stimulating investment activities and economic growth. Liberalising international trade not only affects the economic welfare of countries, but also their political stability.

1.2.3 IMPLEMENTATION OF THE GATS FOR THE TOURISM INDUSTRY

The internationalisation of services is at the very core of today's economic globalisation. The service industries provide links between geographically dispersed economic activities and thus play a fundamental role in the growing interdependence of markets and production activities across nations.

According to Stephenson (1999), service sector production is a core economic activity in virtually all countries, developing and developed alike. It also plays a vital role in world trade. In the 1970s such trade grew more slowly than manufacturing trade, being responsible for only 24 percent of total trade. The WTO (1999j) states that during the past two decades, international trade in services grew significantly faster than merchandise trade. While trade in merchandise increased at about 6 % per annum, services trade expanded at an annual rate of 8 percent between 1980 and 1995. As a result, the services share in world trade rose from 16 to 18 percent over that period. The transportation and travel business accounted for more than 50 % of exports of commercial services in 2000 (WTO, 2001).

Partly as a result of an ever-widening involvement in world trade and partly in response to a decline in the growth of world trade in goods, an interest has arisen in services liberalisation that poses considerable challenges that are quite different from those relating to goods. This interest has been particularly keen since the start of the 1990s. The intangibility of services means that barriers to their trade are not normally evident at the borders. The barriers to trade in services are often more subtle and manifest themselves in the form of legislation and administrative practices. This makes them less transparent, or obvious than tariffs and quotas and more difficult to evaluate in terms of their restrictive impact. Moreover, there is not always a clear line between a 'measure affecting trade in services' and a 'barrier affecting trade in services'. What one government may feel is a necessary regulatory measure, applied in a non-discriminatory manner, may in fact constitute a *de facto* trade barrier in the eyes of a foreign services supplier. It is clear, however, that all-regulatory measures that are applied to foreign service providers in a discriminatory manner constitute barriers to trade.

One of the major outcomes of the Uruguay Round has been the creation of the General Agreement on Trade in Services (GATS). According to the GATT (1994), the GATS is the first multilateral legally enforceable agreement to cover international trade and investment in services, it establishes rules and disciplines on policies affecting access to service markets. Hoekman (1995) states that in some respects, it is a landmark achievement, in other respects it can be considered a significant failure. It is a landmark in terms of creating multilateral disciplines in virgin territory whilst, at the same time, being a failure in terms of generating liberalisation.

The GATS aims to end arbitrary regulatory intervention and assure predictability of laws in order to generate growth in services trade and investment. It creates a framework of multilateral principles and rules for the liberalisation of trade in services, with due respect for national policy objectives and the level of development of each member. Because regulations reflecting these objectives affect the supply of services in various ways, GATS obligations arise from negotiations, rather than flowing directly and automatically from adherence to the Framework Agreement itself.

The effectiveness of GATS can, to some extent, be measured by the schedule of specific commitments signed by each member. A country cannot become a member of GATS without having accepted at least some specific commitments that, once undertaken, are conditioned by the basic principles to assure affective market access. There are disciplines on market access, national treatment, and various regulatory matters that have to be respected by members. In addition, to avoid circumvention or nullification of obligations undertaken, a number of other disciplines also apply to trade policies and practices. Despite this, there is still a wide range for interpretation and implementation that encompasses grey areas whereby the commitment in practice may be less in some circumstances than it is in others. These grey areas and the ability of countries to select which commitments should be covered by their agreement are the reasons why GATS has been successful in attracting support, but may be less than successful in achieving true liberalisation.

GATS encompasses, to a degree, those government regulations that affect the manner in which international trade is executed. The qualification made in this statement results from the fact that, as Brittan observed, GATS is really a collection of bound standstill agreements that cover a specific set of productive sectors (Brittan, 1998). To suggest that GATS affects all aspects of trade and the presence of foreign suppliers in markets (UNCTAD and World Bank, 1995) would be to attribute scope and powers that GATS simply does not possess. It cannot be denied that the set of rules inherent in GATS attempts to produce a more level competitive field on which markets can operate. It attempts to secure transparency and standardisation that is vital to the growth of international trade in services but falls short of its intended target both in terms of scope (such as the exclusion of much of the airline industry) and depth.

According to Handszuh (1994), the travel and tourism industry in many countries has long supported the idea of a services agreement that is effective in terms of opening up new trade and investment opportunities, eliminating practices that restrict competition and guaranteeing long term stability in market access and regulatory fairness. This view may be truer for the tourism industries in industrialised countries than it may be for those that are less developed.

During the Uruguay Round, a Working Group in Tourism Services was formed, and a number of meetings held. From these meeting and subsequent negotiations the Tourism and Travel Related Services (TTRS), category 9 of the Services Sectoral Classification List of GATS, was formulated. The definition of the sector may be regarded as being distinctly limited in its scope. The category is divided into four sub-sectors, the first three of which have associated listing under the United Nations' "Provisional Central Product Classification" (CPC). These sub-sectors are as follows:

- Hotels and restaurants (including catering);
- Travel agencies and tour operators services;
- Tourist guides services;
- Other.

No further sub-classifications are currently provided for under Tourism and Travel-Related Services. Tourism activities that are part of more general services activities, most notably many transport services, but also including certain business services, distribution services and recreational, cultural and sporting services, have typically been placed within those general services categories.

The travel and tourism sector has proved to be popular as a means for countries joining GATS; as of September 1998, 112 WTO Members have made commitments in Tourism and Travel-Related Services (TTRS) under the GATS. This level of commitment is greater than for any other sector. This could demonstrate the desire of most Members to expand their tourism sectors and to increase inward foreign direct investment as part of their efforts to promote economic growth. On the other hand it could signify that many countries see this commitment as being the least onerous because there are other ways of controlling the competitiveness of this market. Despite that, many aspects of the sector are outward-oriented by nature and cannot be protected from international competition, at least in terms of price-quality combinations.

According to Hoekman (1999), the number of commitments made by members varies widely by sub-sector. Hotels and restaurants (sub-sector A) show the greatest number, with 112 Members (i.e. all) making commitments, followed in order by sub-sector B, travel agencies and tour operators services with 89, sub-sector C, tourist guides services, with 54, and sub-sector D, other, with only 13 commitments. Under "other", a number of Members have given no description in their GATS schedule of what is included; other Members have listed specific activities, in one case including transport-related commitments.

GATS could benefit tourism and travel in several ways. According to Handszuh (1995), GATS will contribute to the worldwide development of tourism. It will provide increased transparency by way of clear and detailed information on conditions of access and operation in all services markets of GATS members. The WTO (1998d) states that since the overall objectives of GATS and other accords of the WTO Agreement are to spur trade and economic growth, there will be more demand for exhibitions, incentive and business travel, meeting and conventions. More trade in both goods and services will mean more business opportunities for the travel trade.

1.2.4 EGYPT AS A STUDY AREA

Historically, Egypt is probably the world's oldest civilisation, having emerged from the Nile Valley around 3,100 years ago. For years, Egypt has been the hub for tourists interested in history and the valuable heritage of ancient Egyptian monuments spread all over the country.

Egypt has come a long way in a short time. Ten years ago, the country was suffering enormous economic problems. Its foreign debt was far bigger than GDP, growth was stagnant, and the economy was dominated by an inefficient public sector. The rise of the Islamic trend was threatening the stability of the country.

All these factors have improved radically. Egypt's economic stabilisation programme, initiated in 1990/91, has produced significant results in most macroeconomic areas. Growth has held steady at over 5% per annum; debt has declined to an easily manageable size, and much private industry has grown rapidly. The country's capital markets have been dynamised, and flows of foreign direct investment are substantial and growing. Egypt has also joined various free trade agreements and moved towards the liberalisation of its economic activities. Moreover, the country joined the World Trade Organisation (WTO) and signed for all its agreements in 1995.

The Government in Egypt has a long history of being highly centralised. Considerable attention has been placed on decentralisation and devolution in recent years, much of it prompted by the international community, but much of it based on indigenous, strongly held views. Standard arguments used around the world in defence of devolution have been voiced, including the potential for enhanced efficiency, accountability, and local resource mobilisation and greater democratisation (Fox and Ghanim, 1998). As a result and after decades of state domination of economic activity, many governments around the world are increasingly relying on the private sector to foster economic growth. Governments are becoming less engaged in the direct provision of goods and services, while becoming more active in developing market mechanisms, creating supporting institutions and providing safeguards to ensure equitable distribution.

This trend has also begun in Egypt. In the early 1990s, the Government of Egypt began implementing liberal policies to allow the private sector to lead economic growth. Privatisation is perceived as a cornerstone in the overall economic reform program. On the other hand, the policy and institutional environment has not improved fast enough. Privatisation has also been slow and private sector participation in infrastructure has been modest.

Recently, Egypt embarked on a comprehensive and diversified tourism plan. As a result, new types of tourist products and services have been introduced, investment in tourism has increased and economic performance of the industry has been improved. Moreover, the change in the country's economic orientation and the economic reforms that were put in place resulted in increase in both confidence and investment in tourism. The number of hotels has increased, facilities for servicing the tourism sector have improved and the number of arrivals has risen substantially in relation to the previous decade.

Tourism is a significant contributor to Egypt's economy. Tourism receipts constitute more than a quarter of total foreign exchange earnings and represent, on average around 4% of GDP and around 12% of Egypt's total work force. In addition, the tourism sector in Egypt is poised to be a source of consistent economic growth over the next few years.

But Egypt still has a long way to go. Its competitive position in tourism is weak and is not balanced with its share of world tourism assets. Egypt's tourism potential suffers numerous constraints, among which is the lack of a comprehensive tourism development policy, the quality of service, the shortage of competitive marketing efforts coupled with weak budget allocation for tourist promotion, and the poor image of the Middle East as an insecure region. All these factors are current obstacles to tourism development in Egypt.

In 1962, Egypt applied to join the membership of the GATT; in November of the same year, Egypt was accepted as a non-permanent member for two years. In 1970, Egypt was accepted as a fully-fledged member of the GATT. Since then, Egypt has played a prominent role in the GATT. In 1995, Egypt signed up for membership of the WTO. It committed itself to approve the terms and conditions of the organisation and its affiliated agreements.

Egypt participated actively in the Uruguay Round negotiations on services and has signed for the General Agreements on Trade in services (GATS). Egypt made specific commitments in four out of the 12 sectors in the GATS classification. In general, Egypt's GATS commitments tend to bind the existing policy framework. In some cases, such as insurance services, recent changes have made the applied policy more liberal than Egypt's commitment (WTO, 1999b).

The number of sectors where Egypt has made commitments is a preliminary indicator of how Egypt is similar to, or different from, groups of WTO countries. In general, Egypt is less committed to liberalising its services through GATS.

Tourism as a service sector is already a major contributor to Egypt's balance of payments. Tourism services are generally in the private sector and even government-owned hotel, tend to be managed by international hotel chains. Egypt's commitments in tourism covered three of the four sub-sectors with exemption of sector three (tourist guide services):

- Hotel and restaurant including catering services;
- Tour operators and travel agencies;
- Other.

The magnitudes of the commitments made in the GATS by Egypt suggest that the government was not attracted by the expected benefits of GATS. The implications of the GATS agreement in Egypt's schedule are quite limited. Egypt's GATS commitments in the tourism sector are fairly restrictive with many exemptions to market access and national treatment. Among the Arab countries, Egypt applied the highest level of restrictions on market access and national treatment (Hoekman, 1995).

1.3 AIMS AND OBJECTIVES

This research aims to analyse the terms, codes and practice of the WTO and the GATS and their implications for the tourism sector. This examination is intended to enhance understanding of how the General Agreement is intended to work and how it may help governments exploit the system to their own advantage, especially in the developing countries.

Furthermore, the fundamental purpose of this research is to examine the impacts of liberalisation brought about by the GATS and WTO on tourism development in Egypt; this is done by analysing the factors that influence tourism development in Egypt. These factors include tourism policies, tourism legislation/regulations, the supply sector and the volume of tourist arrivals, and tourism revenues. The results will be used to recommend new policies for the tourism sector for both the governmental and non-governmental organisation.

1.3.1 OBJECTIVES

1. To examine the impacts of GATS and WTO on the tourism legislation and regulations in Egypt.

2. To analyse current tourism policies and how they could be changed to maximise the benefits of GATS and minimise the negative impacts. This is done within the framework of similarities and differences of tourism policies in Egypt in the governmental and non-governmental organisation. The results can be used to identify the weaknesses and strengths, if any, of current tourism policies.

3. To examine the impacts of liberalisation on tourism supply sectors in Egypt in the short and long run in order to help the supply sectors overcome the negative impacts of tough competition from foreign suppliers. In order to do this, the study will examine the characteristics of the supply sectors in Egypt and identify their comparative advantage. The results can be used to identify the difficulties and the problems that face the supply sectors in Egypt. Furthermore, some recommendations to the supply sectors will be made to help them overcome the identified problems.

4. To measure the impacts on tourism flows and tourism revenue in Egypt. The results can be used to appreciate the economic impacts of tourist expenditure on

the Egyptian economy, this means taking in to account the leakage of tourist expenditure (paying for foreign investment) after the GATS.

For greater detail with respect to the aims and objectives, see the research questions in Chapter 6.

1.4 METHODOLOGICAL APPROACH

It is not a simple task to approach a new field of research such as this. GATS is the first multilateral trade agreement discuss trade in services, and trade in tourism. There has been little in the way of structured research into the area of service liberalisation in general and tourism liberalisation in particular. Furthermore, research into multilateral agreements is complicated due to the fact that these agreements operate within a diverse number of rules and disciplines, which affect their implication. Most of the research on multilateral agreements has discussed the economic impacts of such agreements in the area of international trade in goods, which in most cases is difficult to apply to service industries. Trade in services has distinctive features, which distinguish it from trade in goods. Regarding trade in tourism, the matter is more complicated as a result of the features that characterise the tourism industry.

This research investigates the relationship between GATS and tourism development. It aims to measure the impacts of liberalisation and open the market for international competition on tourism development in Egypt.

Since tourism is an interdependent industry, the issue of stakeholders is a fundamental one for any tourism topic under investigation. The research explores and attempts to establish criteria for tourism development in a more globalised and liberalised market, taking into account the global changes, such as technological changes, interdependency and economic changes.

Given the nature of this study, the methodology used will be based largely on quantitative data and complemented by some qualitative analysis. The quantitative data is statistical in nature, which includes designing a comprehensive questionnaire. Qualitative approaches include semi-structured interviews, observations and policy review with key players both from the public and private sector.

Three independent variables are used in this study as factors that influence the perceptions of respondents towards tourism liberalisation. These are the government, private enterprises and tourism experts.

The phenomena that have been studied in this research are:

- Tourism liberalisation: concepts, policies, and constraints;
- GATS and WTO: motivations, modes of supply, principles and rules, and inter-sectoral relationship;
- Impacts of GATS: tourism revenue, private enterprises and employment.

The results from the qualitative methods and the pilot study helped design the questionnaire. The questionnaire was implemented in a face-to-face manner in order to ensure a higher response rate and give the chance to the researcher to prompt when required. The returned valid questionnaires were analysed by descriptive statistics (frequency, mean, standard deviation, t-test and ANOVA) and factor analysis. Details of how the research methodology was determined will be discussed in Chapter Six.

1.5 RELEVANCE TO THE LITERATURE

Is GATS redressing imbalances or impeding world trade in tourism sectors? What is the implication of GATS for the tourism industry? Will liberalisation of trade in services lead to further growth of world tourism? These are complex issues that need to be faced in order to understand to what extent the liberalisation of trade in services benefits the tourism industry and to what extent tourism needs to be liberalised.

Economists tell us that free trade is superior to no trade. The theory of comparative advantage says that countries prosper first by taking advantage of their assets in order to concentrate on what they can produce best, and then by trading these products for products that other countries produce best. In other words, liberal trade policies multiply the rewards that result from producing the best products, with the best design, at the best price.

But success in trade is not a static outcome. The ability to compete well in particular products can shift from company to company when the market changes or new technologies make cheaper and better products possible. Furthermore, competitiveness can also shift between whole countries. A country that may have enjoyed an advantage because of lower labour costs or because it had good supplies of some natural resources, could also become uncompetitive in some goods or services as the economy develops.

The alternative is protection against competition from imports (goods or services) that may lead to bloated, inefficient companies supplying consumers with outdated, unattractive product. Ultimately, factories close and jobs are lost despite the protection and subsidies. One of the objectives of the WTO and the GATS is to prevent such a self-defeating and destructive drift into protectionism.

Based on the above illustration, all the member countries of GATS will benefit in one way or another from the GATS but there is unresolved question about what is going to happen to the developing countries. Will the liberalisation and promoting free trade bring only benefits to them?

Comparative advantage is the cornerstone of the GATS, realising the competitiveness and comparative advantage of the country at its heart. To examine the impacts of the GATS on tourism development, especially on developing countries, there is a need to understand first what is the basis for trade, in other words, it is necessary to define the resources of comparative advantage, and identify the gains of trade.

Although eminent economists throughout the past two centuries have discussed the issues surrounding trade liberalisation in general, issues with respect to trade liberalisation in the service industries have largely been neglected. The focus on the tourism sectors offered by this research will provide new insight and new impetus to the debate regarding the efficacy of liberalised trade in generating general development. From this point of view, the thesis will cover truly uncharted waters and make a significant contribution to the literature.

Tourism as a service product has specific characteristic that set it apart from the more general goods sold in market place. An understanding of the complexity of the service product concept is an essential prerequisite to identifying the resources of the comparative advantage in the tourism sector. This theoretical approach (comparative advantage and protectionism) helps not only to determine the research problem but also to identify the main variables of the research. These include the tourism policy, tourism legislation and regulation, the supply sector, tourism numbers, and tourism revenues.

In order to reveal the complex nature of liberalisation under GATS and tourism development, an analytical model based on a combination of identifying the comparative advantage of the country and the trade barriers that face the tourism sector is used to illustrate the way that GATS could help tourism development.

1.6 CONTRIBUTION TO KNOWLEDGE

The results of this research will hopefully be useful in a number of ways:

- As the research will examine the resources of the comparative advantage in the tourism sector, this might help policy makers and planners identify the country's comparative advantage in the tourism sector according to the criteria adopted in the research.

- As the WTO and GATS are a very new area, the research might help countries, especially developing countries, to understand better the terms and the key concepts of the WTO and the GATS agreement. This might help countries to understand how to use the GATS to achieve their goals. Then lessons might be learnt as to what could be incorporated into future planning for the tourism sector after the implementation of GATS.

- It will assist policy makers and planners in developing countries to prepare for the GATS in the transitional period, by adopting new ideas for both the governmental and non-governmental organisation.

- The findings may assist tourism planners, and offer input to policy makers not only in Egypt but also in any other developing countries in the same situation. This can be seen as a challenge to restructuring an economy and the problems of development after the implication of the GATS.

- This investigation may benefit the tourism supply sectors (private and public) with planning and resources allocation. Further more, the research will provide the supply sectors with new ideas built upon the analysis to face foreign competition and help them determine with the most suitable solution to overcome negative impacts. This could be useful for any developing country's that has the same or similar characteristics to the supply sector in Egypt.

- The investigation may help to understand how significant tourism spending is to the Egyptian economy. The findings will help tourism policy and planners to develop strategies for the future in order to minimise the leakage of tourism expenditure.

- Finally, the investigation of the GATS' implication for the tourism industry and identifying the competitiveness and comparative advantage of the country, which are at the heart of the GATS, will provide a rich and deeper contribution to the body of knowledge on tourism liberalisation, and encourage more studies within this area.

1.7 LIMITATIONS OF THE STUDY

Data availability and collection are the first obvious limitations. It took approximately two years devoted to data collection, structuring and interpretation. The many related tourism institutional authorities in Egypt meant that data not only had to be obtained but also had to be cross-checked in order to determine consistency and reliability.

Furthermore, when the research took place, the GATS was not enforced and few people knew about it. Therefore, it was difficult to get people to take part in the survey, essentially because they did not know about the GATS and its implications.

1.8 THE STRUCTURE OF THE THESIS

The thesis is divided into thirteen chapters.

Chapter One: is a general introduction to the thesis. It consists of the research background and the research problem, objectives of the study, the methodological approach, the contribution to the body of knowledge arising from this research and its relevance to the literature. This chapter also discusses the structure of the thesis.

Chapter Two: shows the first part of the literature review, focusing on the international trade and international tourism. It examines the development and global significance of tourism. It analyses why tourism is increasingly referred to as the world's biggest industry and summarises major historical trends. Then moves on to explore the development of international trade and how tourism plays an important role in it, particularly with respect to international trade in services. The chapter will finish by investigating the economic structure of the supply sectors in tourism.

Chapter Three: is the main general theoretical framework of the study. Which describes the complexities of free trade in general and in tourism in particular. It considers the determinants of the composition and direction of trade under free trade. So this investigates the various sources of trade: absolute advantage, comparative advantage, based on comparative labour productivity, comparative advantage, based on differential endowments of productive factors, and other sources of comparative advantage that are related to technological differences, economies of scale, and other dynamic phenomena. Alternative facts of international tourism based on imperfectly competitive markets are then examined, including the demand for ranges of tourism product qualities, the supply of differentiated products and differences in technology. The chapter also examines international trade policies and instruments (such as tariffs, quotas and etc).

Chapter Four: examines the globalisation and liberalisation of economic activities through regional and multilateral agreement. It explains the new world trading system through the WTO and its agreements. It focuses on issues related to developing countries and identifies who are the winners and who are the losers in the new system.

Chapter Five: focuses on the GATS and its implementation for the tourism industry. The chapter discusses what the GATS does to bind current trade in service policies and whether it has established a mechanism that is likely to induce significant liberalisation in the future. Second, what are the implications for the tourism industry. Third, the chapter will discuss the weaknesses of the GATS in general and for tourism in particular.

Chapter Six: discusses the methodological issues applied in the study to satisfy the thesis' objectives. To achieve this aim, this chapter discusses the steps involved in the research process. It also discusses the issues of reliability and validity, and the limitations faced in this research.

Chapter Seven: gives a basic background of Egyptian history and geography in order that tourism may be understood in its national and regional context. The chapter also attempts to discuss the economic structure of Egypt and the recent economic developments. It also summarises the business environment in Egypt and examines whether the private sector in general and tourism private sector in particular have led economic growth.

Chapter Eight: attempts to discuss the growth of international trade in Egypt and the trade policy options towards liberalisation. It discusses the macroeconomic policies that can affect foreign direct investment in Egypt.

Chapter Nine: focuses on the tourism industry in Egypt. It attempts to summarise recent development in the tourism sector and Egypt's policy options regarding liberalisation of the tourism industry. The chapter specifically addressed the following questions:

- How important is the tourism sector to the Egyptian economy?
- What is the level of openness in Egypt's trade in tourism?
- What are the main current tourism liberalisation policies?
- What are the main features of Egypt's GATS commitments regarding tourism?

Chapter Ten: is the first analysis chapter. It summarises the main features of the sample size. The chapter starts with an overview of the sample and its main characteristics and its relevance and implications to the research. The examination of the sample characteristics demonstrates that different types of firms, categories and size would experience different levels of impact from GATS on their business, in both short and long-term.

Chapter Eleven: discusses the application of the frequency analysis and cross-tabulation analysis. The objective is to see whether there were any significant patterns in the data as well as to demonstrate the presence or absence of a relationship between variables. Whether and to what extent Egypt will benefit from the full implementation of the Uruguay Round is difficult to say, although this chapter makes an attempt at assessing the impacts of the GATS and WTO on tourism development in Egypt, taking into account the level of commitments made by Egypt. The chapter deals with three questions in particular:

- Does the macroeconomics environment offer the necessary conditions for tourism liberalisation?
- What are the main features of Egypt's GATS commitments?
- What are the impacts of GATS on tourism development?

Chapter Twelve: is the last chapter of the analysis to be considered in this thesis. It offers in-depth analysis to the phenomena been studied. It is divided into three sections. The first section investigates the perception of the community groups on tourism liberalisation and compares the ratings of the three groups in order to identify differences in their perceptions.

The second, deals with the opinions of the three groups on foreign trade policies in Egypt (WTO and GATS), and presents a proposal for further tourism liberalisation policy for the tourism sector.

Section three presents the perceptions of the three groups with respect to the impacts of GATS on tourism development in Egypt.

Chapter Thirteen: consists of the conclusion and recommendations for policy-making and further study.

CHAPTER TWO

INTERNATIONAL TRADE AND INTERNATIONAL TOURISM

2.1 INTRODUCTION

International trade is vital to the economic health of any nation. The world's major economies have always been linked in various ways, but dramatic improvements in transportation, telecommunications, and international relations in recent decades have pulled nations ever closer together. We now live in "one world", at least in an economic sense. It is fashionable to characterise our age in terms of interdependence. This is not a new phenomenon: for centuries the world economy has become ever more integrated. In the past quarter-century, the pace of integration has accelerated, and the implications of interdependence have become more pronounced, reflected by the duration of international economic conflicts, the extent of economic gains and losses to the parties affected, and the inadequacy of policy instruments to resolve conflicts.

In many economies, the travel and tourism sector has for some time been recognised as a major area of activity which both draws on the resources of those economies and affects their nature and development. It is now generally accepted that international tourism constitutes one of the most significant of global trade flows. Additionally, the increasing share of services in international trade has focused attention on tourism as a major contribution to the balance of payments. Tourism has become a major component of economic strategies in many countries.

According to Dicken (1992), economic activity is becoming not only more internationalised, but, more significantly, it is becoming increasingly globalised. These terms are often used interchangeably, but they are not synonymous. Internationalisation refers to the increasing geographical spread of economic activities across national boundaries, and as such it is not a new phenomenon. Globalisation of economic activity is qualitatively different. It is a more advanced and complex form of internationalisation which implies a degree of functional integration between internationally dispersed economic activities (Parker, 1998).

Globalisation refers to the growing interactions of countries in world trade, foreign direct investment and capital markets (UNCTAD, 1996a). It is popularly described as the absence of borders and barriers to trade between nations (Ohmae, 1995). In fact, globalisation is the product of liberalisation, which has been the hallmark of economic policy throughout the world, during the past decade, but it has also set in motion forces working to accelerate liberalisation. Both globalisation and liberalisation have increased the potential for international trade to become an unprecedented engine of growth and an important mechanism for integrating countries into the global economy (UNCTAD, 1999e).

The globalisation process has been abetted by technological advances, and by a rapid liberalisation and deregulation of trade and market flows, both at the national and international levels (UNCTAD, 1996c). For more than a century, the driving force behind globalisation has been the expansion of trade in goods and services. And throughout the early decades of the 21st century, trade will continue to drive global integration, especially among developing countries.

The globalisation of production and the liberalisation of trade offer opportunities for all countries and enable developing countries to play a more active role in the world economy. At the same time, according to the UNCTAD (1996c) these processes have also increased the complexity and challenges involved in interdependence, increasing the risks of instability and marginalisation.

Technological advances, the increased mobility of production factors and regional and international arrangements have opened the door to the prospect of considerable gains in productivity and wealth creation. Some developing countries are already reaping the benefits. Others are less well placed to seize these opportunities. In principle all should benefit if governments create the necessary conditions for promoting sustainable development, economic growth and stability (UNCTAD, 1996b).

Meier (1980) argues that the outstanding feature of the internationalisation of the economic system has been the increase in the flows of commodities, factors of production management, technology and financial capital across national borders. Not only have the movements of these goods, services and factors increased, but they have also become more responsive, or more elastic, to differences between domestic and foreign variables.

The internationalisation of services is at the very core of economic globalisation. Service industries provide links between geographically dispersed economic activities and thus play a fundamental role in the growing interdependence of markets and production activities across nations. Moreover, many services considered non-tradable only a few years ago are now seen as traded activities, as the tourism industry expands the boundaries of tradability. This internationalisation process is reflected in statistics which indicate that during the last two decades, while world output has been growing at about 4% per year, world trade has been growing at about 8% per year (World Bank, 1997). Export and import shares of output have increased considerably particularly in all industrial sectors (Meier, 1980).

This chapter examines the development and global significance of tourism. It analyses why tourism is increasingly referred to as the world's biggest industry and summarises major historical trends. Then moves on to explore the development in international trade and how tourism plays an important role in it, in particularly in the international trade in services. The chapter finishes by investigating the economic structure of the supply sector in tourism.

2.2 TOURISM-THE WORLD'S BIGGEST INDUSTRY

Tourism is the world's largest industry with no signs of slowing down in the 21^{st} century. According to the World Tourism Organisation (1999b), there has been a dramatic increase in international tourism numbers since the end of the Second World War. Tourism has grown at an average rate of 7% per annum in arrivals and 12% per annum in receipts. Few, if any, other economic activities have achieved such a consistently high growth rate over such a long period of time. The economic flows generated by international tourism have become essential factors of economic growth and international economic relations for many countries.

In 1950, according to WTO/OMT (1996b) only 25 million international tourists were recorded worldwide. This number increased to more than double by 1960 to reach 69 million arrivals. WTO/OMT (1996b) shows that there were 222 million international tourist arrivals in 1975. The volume of travellers steadily increased to 458 million by 1990. The upward trend resumed from 1990 to 1995, increasing by 23.9% to reach a total of 565 million in 1995 (see table 2.1). The large growth in tourist flows since 1970 can be attributed to 'mass tourism', which has brought very high concentrations of tourists to certain zones, particularly coastal regions.

Table 2.1: International Tourist Arrivals and Receipts World-wide (1950-95)

Years	Arrivals (millions)	% Change	Receipts (billions US$)	% Change
1950	25.282	-	2.100	-
1960	69.320	174.187	6.867	227.000
1970	165.787	139.161	17.900	160.666
1975	222.290	34.081	40.702	127.385
1980	285.997	28.659	105.320	158.758
1985	327.188	14.402	118.084	12.119
1990	458.229	40.050	268.928	127.742
1995	565.495	23.397	405.110	50.638

Source: World Tourism Organisation (WTO/OMT) (1996b)

Callaghan (1994) states that this growth has been moderately steady, although there have been a number of periods in which it was interrupted. These were:

- **1968-1969**

The lower rates of growth in tourism during this period were associated with the downturn in the US economy and the adverse economic effects of US involvement in the Vietnam War. This had repercussions on the economies of a number of the major tourist-generating countries of Western Europe and led to a general fall in tourist numbers.

- **1973-74**

Following the 1973 Arab-Israeli war, OPEC substantially increased the price of oil. The consequence of this price rise for tourism was most pronounced in North America. In Europe, the effect was temporarily to reduce the rate of growth of tourism rather than to cause an actual decline in international arrivals.

- **The Early 1980s**

This period was characterised by more fundamental economic problems. For several years during the economic recession of the early 1980s the rate of international tourism growth levelled off. By 1984, it had begun to rise again, and that rise continued into the late 1980s. Witt et al (1987) state that the decade 1970 to 1980 was the most significant post-war period in terms of worldwide increases in international tourist numbers.

According to the World Tourism Organisation (1995b), revenues from international tourism (not including revenue from the transport sector) have increased significantly since 1950. In 1950, tourism generated US$2.1 billion, and by 1960 this had reached US$6.86 billion. Steady growth during 1960-1970 was followed by a considerable increase between 1970 and 1980. In 1970 the tourism receipts worldwide were about 17 billion US$, with an160% increase over 1960.

Youell (1998) states that the sharp increase in international tourism receipts is not only a consequence of inflation in the 1970s; it is also the result of better-quality services being offered and better equipment being used. According to the World Tourism Organisation (1995b), in 1980 tourism generated US$105.32 billion. By 1995, this had reached US$ 405.11 billion. As shown in figure 2.1, tourism receipts have grown more rapidly and more regularly than world arrivals (see figure 2.1). Thus, during 1960, receipts increased by 227% while arrivals increased by 174%. This increase continued until the 1990s. While tourism arrivals increased by 23% from 1990 to 1995, tourism receipts had achieved 50% for the same period.

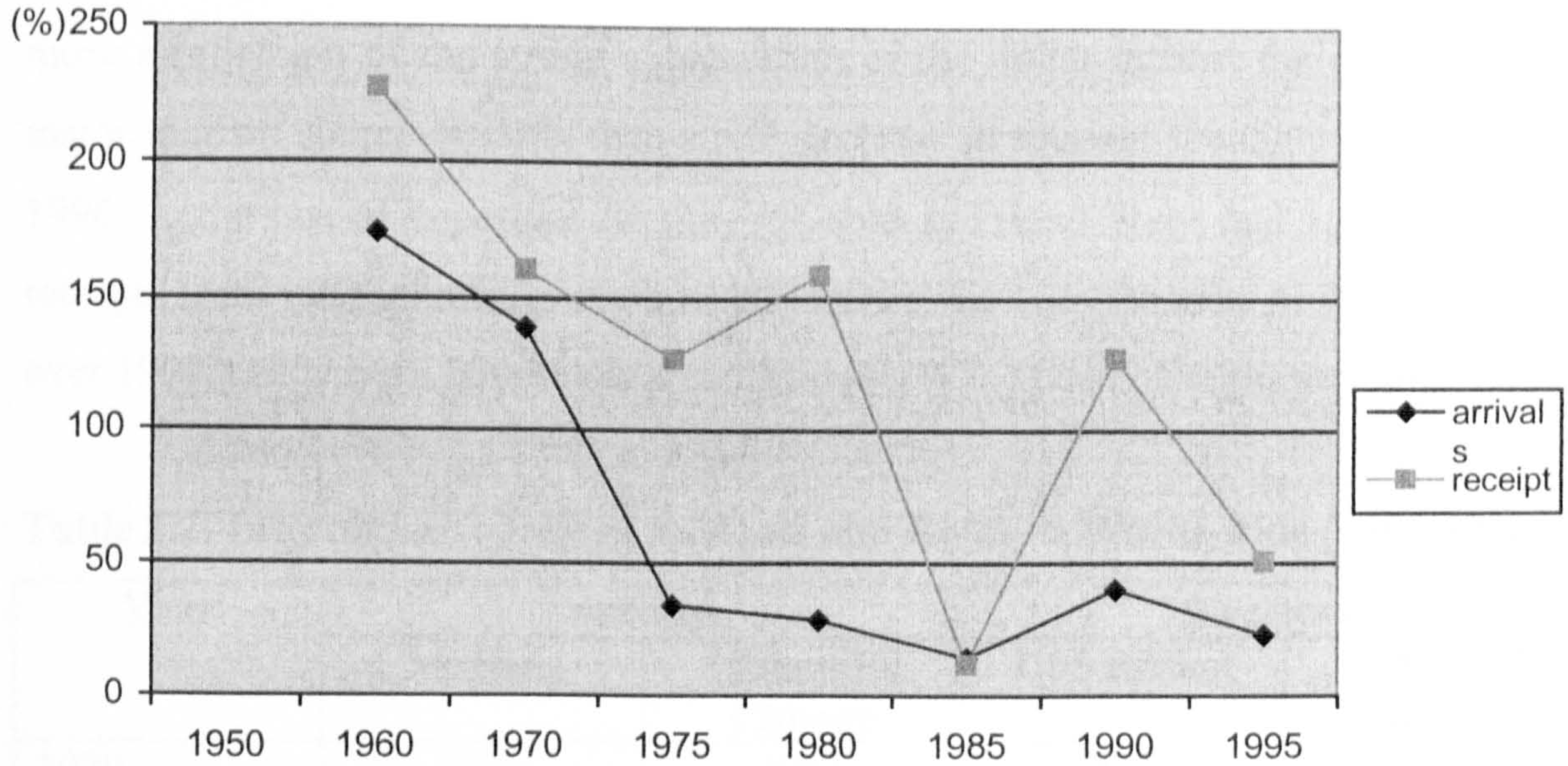

Figure 2.1: Percent Change in Tourist Arrivals and Receipts (1950-1995)

Source: World Tourism Organisation (WTO/OMT) (1996b)

This graph shows that the rate of increase is slowing down – but this is a natural event as when the base expands then the rate of growth will decline.

2.2.1 RECENT TOURISM TRENDS

The WTO/OMT (1999b) shows that in 1998, tourist arrivals maintained a sustained growth of 2.5% to 635 million and tourism receipts (excluding international transport) grew to US$ 439 billion. These trends were mainly determined by the set back of international tourism in East Asia and Pacific in 1998.

Looking at the trends of international tourist arrivals during 1989-1998, the growth rate of arrivals worldwide slowed in the second half of the decade to 3.2% from 5% in the first half. For the ten year period, 1989-1998, the annual average was 4.3%, but this masks wide variations from one region to another. In volume, the total number of tourists worldwide increased by 199 million between 1989 and 1998.

The average annual growth in receipts slowed from 10% between 1989 to 1993 to 5.9% from 1994 to 1998. However, due to the sharply fluctuating value of the US dollar over the past ten years, the base currency used for global comparisons, this slowdown and the annual fluctuation in international tourism receipts need to be interpreted with caution. In 1998, for example, the 2% rise in receipts over 1997 is more a reflection of the strong appreciation of the dollar against the currencies of major tourism source markets than a real decrease in tourism spending compared to 1996. In the case of important destinations, such as France, Italy, and Spain, the total receipts from international tourism in US dollars show an increase of 6.3% in 1998 over 1997, reflecting a boom in tourism activity (WTO/OMT, 1999b) (see table 2.2).

Table 2.2: International Tourist Arrivals and Receipts World-wide (1989-1998)

Year	Arrivals		Receipts	
	Millions	% Annual Change	US$ Billion	% Annual Change
1989	426	8.02	221	8.31
1990	458	7.45	269	21.54
1991	464	1.25	278	3.21
1992	503	3.49	315	13.52
1993	519	3.12	324	2.85
1994	550	6.05	354	9.23
1995	565	2.73	405	14.44
1996	597	5.49	436	7.52
1997	611	2.39	436	0.09
1998	526	2.37	445	2.01

Source: World Tourism Organisation (WTO/OMT) (1999b)

Vellas and Becherel (1995) state that the annual trends in arrivals represent reliable indicators of industry growth. The 5% annual increase in international tourist arrivals worldwide between 1989 and 1993 demonstrate that the industry is remarkably resistant to economic fluctuations and other problems. In the second half of the decade (1994-1998) the average annual increase in arrivals did slowed to 3.5% but this can still be considered remarkable in view of the slow economic recovery, sustained high unemployment in major industrialised countries and the Asian financial crisis. What is more important here is the increase in the tourism receipts (see figure 2.2).

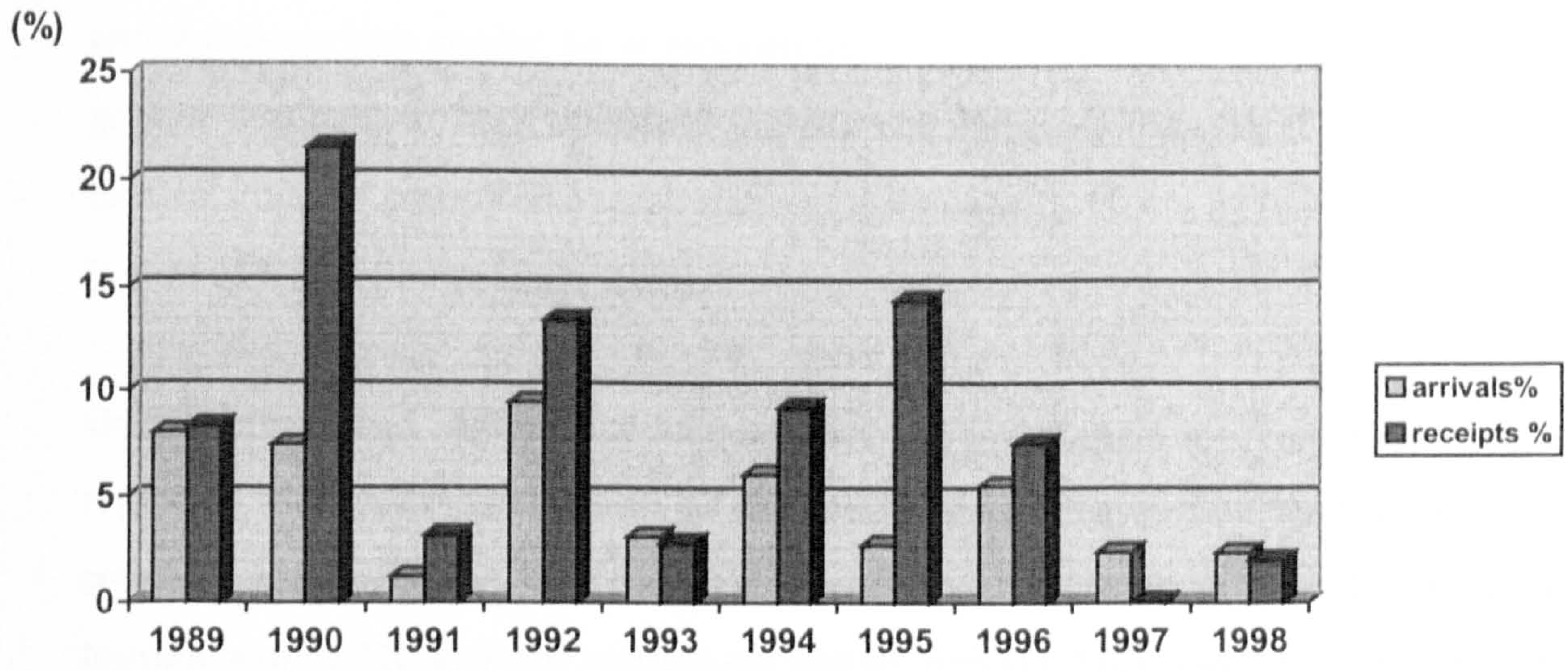

Figure 2.2: Percent Change in Global Tourist Arrivals and Tourism Receipts (1989-1998)

Source: World Tourism Organisation (WTO/OMT) (1999b)

According to the WTO/OMT (1999b), the strong recovery of tourism travel worldwide was further confirmed by the growth rate of air traffic worldwide in 1996. Nevertheless, preliminary traffic figures for 1998, released by the International Civil Aviation Organisation (ICAO), point to a one percent increase over 1997 both for total and for international scheduled traffic of the world airlines.

This substantial deceleration, from an average increase of 7% in the previous five years and 8% in 1997, reflects, in particular, a small decline of the airlines of the Asia/Pacific region, which contribute more than a third of world traffic and, until recently, achieved high rates of growth. With the exception of airlines from the Middle East and Africa, which showed little change in traffic, airlines from other regions continued to achieve traffic growth, but at levels below recent annual trends.

2.2.2 INTERNATIONAL ARRIVALS AND RECEIPTS BY REGION

Europe is the world's main destination, although the number of international arrivals is growing at a slower rate than in other regions. According to the WTO/OMT (1996b), it has experienced a significant loss of 8.6 percentage points in its share of tourist arrivals since 1970. It receives 59% of the world's visitors who contribute about 53% of total world receipts. In comparison, the East Asia and Pacific region and the American region have proportionally higher revenues because they attract greater numbers of high spending tourists and business travellers. The Americas remain a distant second in overall share of arrivals with 19.4% of the market in 1997 (a loss of 6.3% points since 1970).

On the other hand, Africa, the Middle East and South Asia are very weak tourism regions. Compared to the rest of the world, they receive few tourists and little revenue from tourism. For example, in 1997 Africa received only 23.15 million tourists with 3.7% share of world total tourist arrivals, followed by the Middle East with 2.43% share of the world's total, while South Asia had achieved the lowest figure with only 0.79%. These regions do not have the necessary infrastructure and superstructure to develop their tourism sector and suffer strong competition from other advanced regions (WTO/OMT, 1999b).

In contrast, the number of international arrivals to Africa, Middle East, South Asia and East Asia Pacific is growing at a faster rate than in other regions. East Asia and the Pacific have made the most significant gain, as reflected in the development of their economies during the last decade (see table 2.3).

Table 2.3: Arrivals of Tourists from Abroad by Regions (1980-1997)

Regions	Arrivals (Thousands)					Share of world total (%)	
	1980	1994	1995	1996	1997	1980	1997
World	**285.997**	**550.471**	**565.495**	**596.524**	**610.763**	**100.00**	**100.00**
Africa	7.349	19.092	20.357	21.824	23.157	2.56	3.79
Americas	61.368	106.449	110.479	116.942	118.481	21.46	19.40
East Asia/Pacific	21.480	76.788	81.355	88.985	87.953	7.51	14.40
Europe	186.111	331.484	335.599	350.255	361.509	65.07	59.19
Middle East	7.467	12.792	13.505	14.084	14.833	2.61	2.43
South Asia	2.242	3.866	4.200	4.434	4.830	0.78	0.79

Source: World Tourism Organisation (WTO/OMT) (1999b)

Table 2.4 shows the changes in tourist arrivals between 1997 and 1998. In 1998, the Africa region showed the strongest expansion in arrivals for 1998, up 7.5% over 1997. South Asia experienced less significant increases, where a gain of 5% in arrivals showed a small increase compared to the 8.9% growth reached between 1996 and 1997. After a robust increase of 9.4% in 1996, arrivals in East Asia and the Pacific fell -1.2% in 1997 and an additional loss of 1.2% in 1998. The decrease in the growth of tourism in the region occurred as a result of the financial crisis of most traditional tourism destinations.

In the Americas, the rate of growth of arrivals slowed down, moving from an increase of 5.8% between 1995/1996 to 1.3% between 1996/1997 and an improvement in 1998 of 1.4% over 1997. Arrival levels also decelerated in Europe, going from an increase of 4.4% in 1995/96 to a 3.2% increase between 1997/1998. The Middle East experienced a stagnation in the growth rate of arrivals of 5.3% between 1996/97 and 1997/98.

Table 2.4: Tourist Arrivals by Region (1997-1998)

	Tourist arrivals (thousands)		**% Change**	
	1997	1998	98/97	97/96
World	**610.763**	**625.23**	**2.4**	**2.4**
Africa	23.157	24.903	7.5	6.1
Americas	118.481	120.190	1.4	1.3
East Asia/Pacific	87.953	86.927	-1.2	-1.2
Europe	361.509	372.523	3.0	3.2
Middle East	14.833	15.622	5.3	5.3
South Asia	4.830	5.071	5.0	8.9

Source: World Tourism Organisation (WTO/OMT) (1999b)

Recent trends in world tourism receipts highlight the considerable changes that are taking place. Table 2.5, shows that Europe's share of world tourism receipts had fallen to 50% in 1997 from nearly 60% in 1980. During the same period, the share of East Asian and Pacific countries of receipts grew considerably from 8% to nearly 18%, demonstrating clearly that tourism is first and foremost an economic phenomenon.

In the American regions there was a slight growth in the market share from 24% of total receipts in 1980 to 27% in 1997.

Africa and Middle East and South Asia experienced a slight loss of market share. For these regions, political instability and more especially the problems created by slow economic development are the principle obstacles to increasing the market share.

Over the period 1980 to 1997, East Asia and the Pacific expanded their share of global tourism receipts significantly by 9.3 percentage points. Europe and Africa lost 10.24 and .05 percentage points respectively. The share of the Middle East also experienced a loss of 1.19% in 1980 and 1997. South Asia saw a slight loss (from 1.47% in 1980 to 1.3% in 1997). The share for the Americas did not change significantly between these two years, with an increase of 3.13% (see table 2.5).

Table 2.5: International Tourism Receipts by Regions (1980-1997)

Region	Receipts (US$ million)					Share of world total (%)	
	1980	1994	1995	1996	1997	1980	1997
World	**105.320**	**353.998**	**405.110**	**435.594**	**435.981**	**100.00**	**100.00**
Africa	2.711	6.844	7.360	8.732	9.018	2.57	2.07
Americas	25.389	95.197	102.723	112.448	118.767	24.11	27.24
East Asia/Pacific	8.720	63.411	74.520	82.337	76.627	8.28	17.58
Europe	63.484	179.081	209.490	219.888	218.155	60.28	50.04
Middle East	3.470	6.395	7.522	8.241	9.135	3.29	2.10
South Asia	1.546	3.070	3.495	3.948	4.279	1.47	0.98

Source: World Tourism Organisation (WTO/OMT) (1999b)

On the other hand, as shown in table 2.6, the Middle East region experienced the highest increase (6.4%) in receipts of all regions between 1997/98. Receipts increased more moderately in Africa by 5.9%.

Europe exhibited an increase of 3.6% over 1997, a recovery in the growth rate of tourism receipts from -0.8% between 1996/97. Tourism receipts in the Americas and South Asia experienced a growth between 1997/98, rising respectively 2.1 and 2.8%.

East Asia and the Pacific showed the strongest drop in the growth of tourism receipts with below 3.8% growth between 1997 and 1998. This drop follows the loss of 6.9% of 1997 over 1996 (see figure 2.3).

Table 2.6: Tourist Receipts by Region (1997-1998)

	Tourism receipts (US$ million)		% Change	
	1997	1998	98/97	97/96
World	**435.981**	**444.981**	**2.0**	**0.1**
Africa	9.018	9.018	5.9	3.3
Americas	118.767	118.767	2.1	5.6
East Asia/Pacific	76.627	76.627	-3.8	-6.9
Europe	218.155	218.155	3.6	-0.8
Middle East	9.135	9.135	6.4	10.8
South Asia	4.279	4.279	2.8	8.4

Source: World Tourism Organisation (WTO/OMT) (1999b)

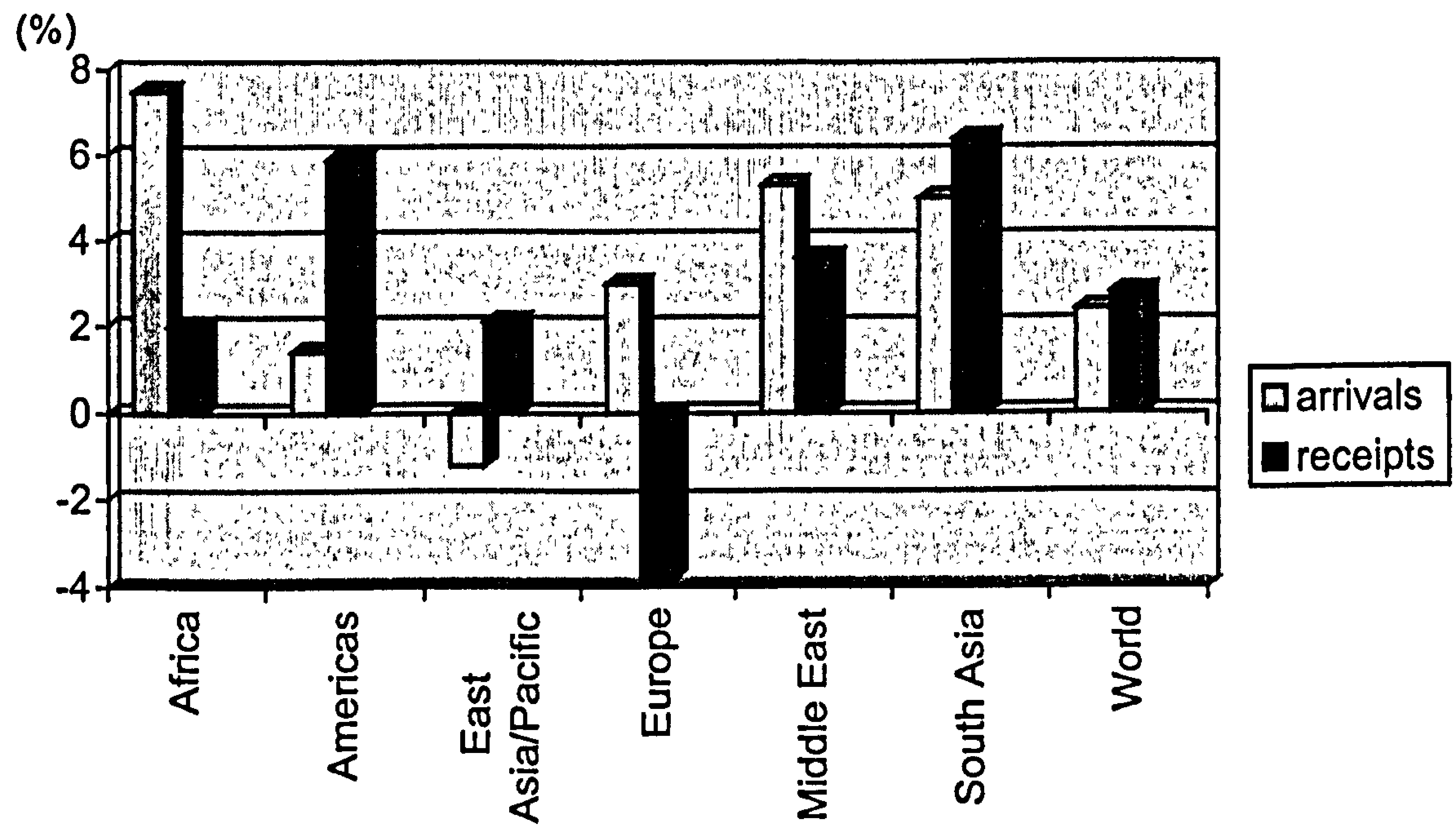

Figure 2.3: Percent Change in Global Tourist Arrivals and Receipts by Region (1997-1998)

Source: WTO/OMT (1999b)

2.2.3 THE ECONOMIC IMPORTANCE OF TOURISM

Figure 2.4 illustrates the trends of the tourism balances (i.e. receipts-expenditure) of the world regions.

- East Asia and the Pacific turned a deficit of US$ 4.300 million in 1989 in to a surplus of US$ 724 million in 1997.
- All the other regions improved their balance between 1989 and 1997.

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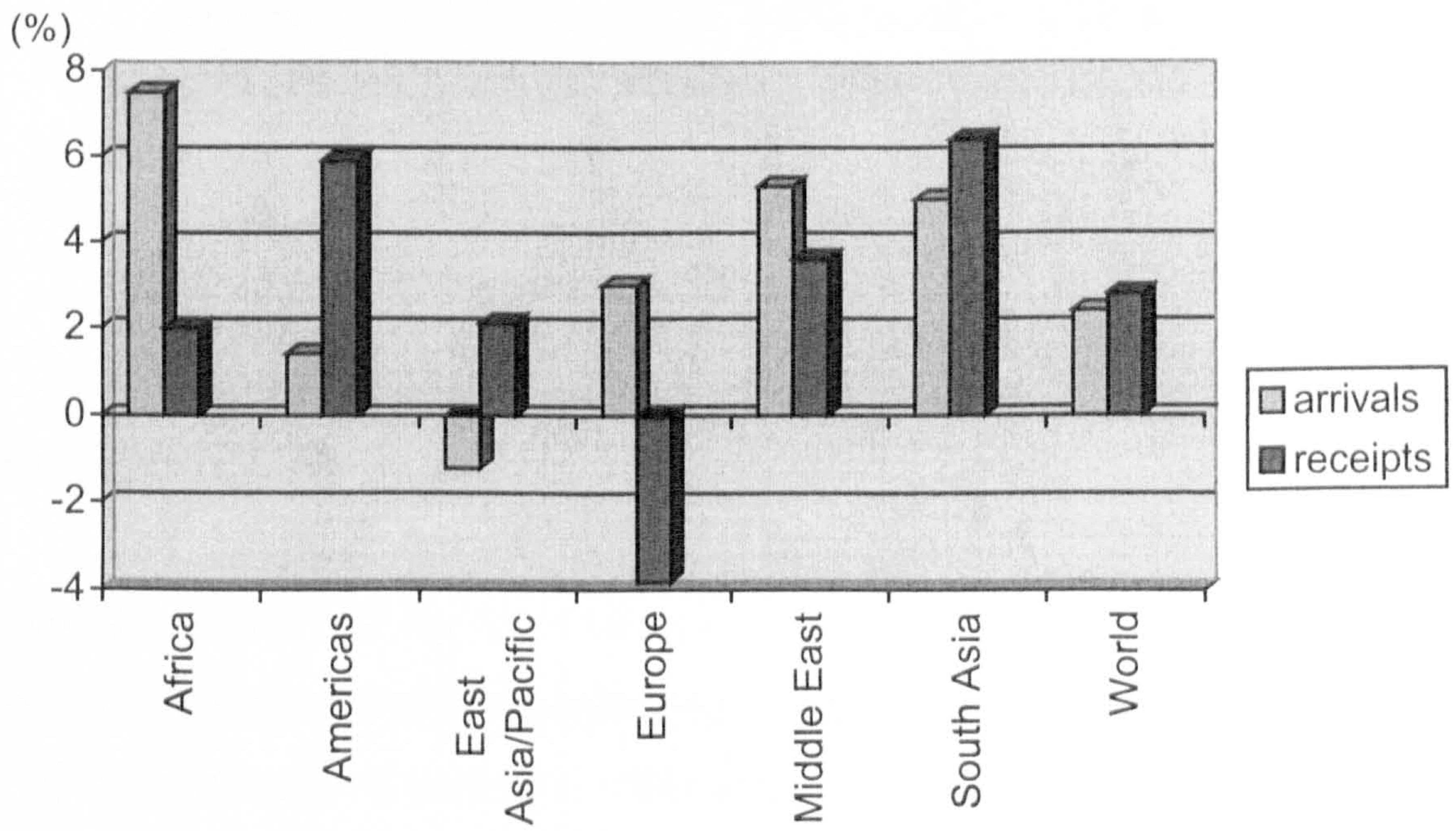

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- All the other regions improved their balance between 1989 and 1997.

- The Americas obtained the highest share of the tourism balance, followed by Europe, which improved its share slightly compared with Americas.
- Africa turned US$ 813 million in 1989 to US$ 2.017 billion in 1997.

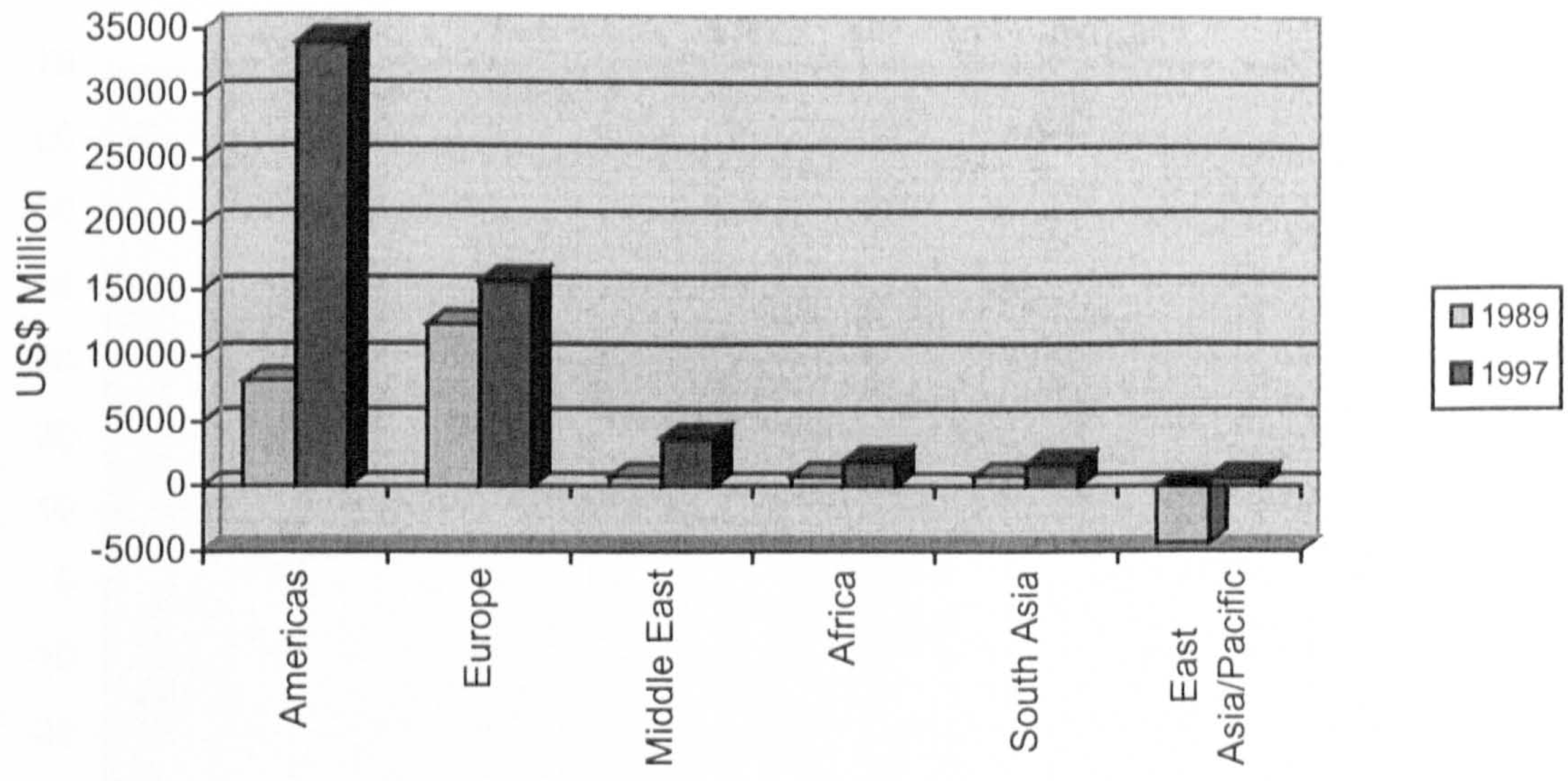


Figure 2.4: Tourism Balance Regional Trends (1989-1997)

Source: World Trade Organisation (1999b)

Figure 2.5 shows that the travel account balance for different regions (including travel fares) in the developed countries as a whole has been in decline since 1980. Their combined deficit peaked in 1990 at US$ 17.3 billion. In 1997 it showed a surplus of almost US$ 0.8 billion. These results are attributed mainly to huge deficits of US$ 28.0 billion in Germany and US$ 35.2 billion in Japan. Half of the developed economies, however, experienced a travel account surplus in 1997.

Travel account balances in the developing economies, in contrast with the developed economies, has been persistently in surplus, widening steadily from US$ 4.6 billion in 1980 to US$ 33.7 billion in 1989 and US$ 62.2 billion in 1997, a reduction of US$ 3 billion compared to 1995. Their surplus in travel almost doubled in the second half of the 1980s, mainly attributed to a sharp widening of surplus in Asia and Pacific (excluding Japan, Australia and New Zealand) and Africa. In 1997, their surplus was US$ 62.2 billion, offsetting more than two thirds of their current account deficit. All developing regions have experienced steadily widening travel surplus in the past decade.

Transition economies recorded a deficit of their travel account in 1995 reflecting the boost in travel abroad of some markets such as the Russian Federation. The year 1997 witnessed a trend reversal with a positive travel balance of almost US$ 2 billion.

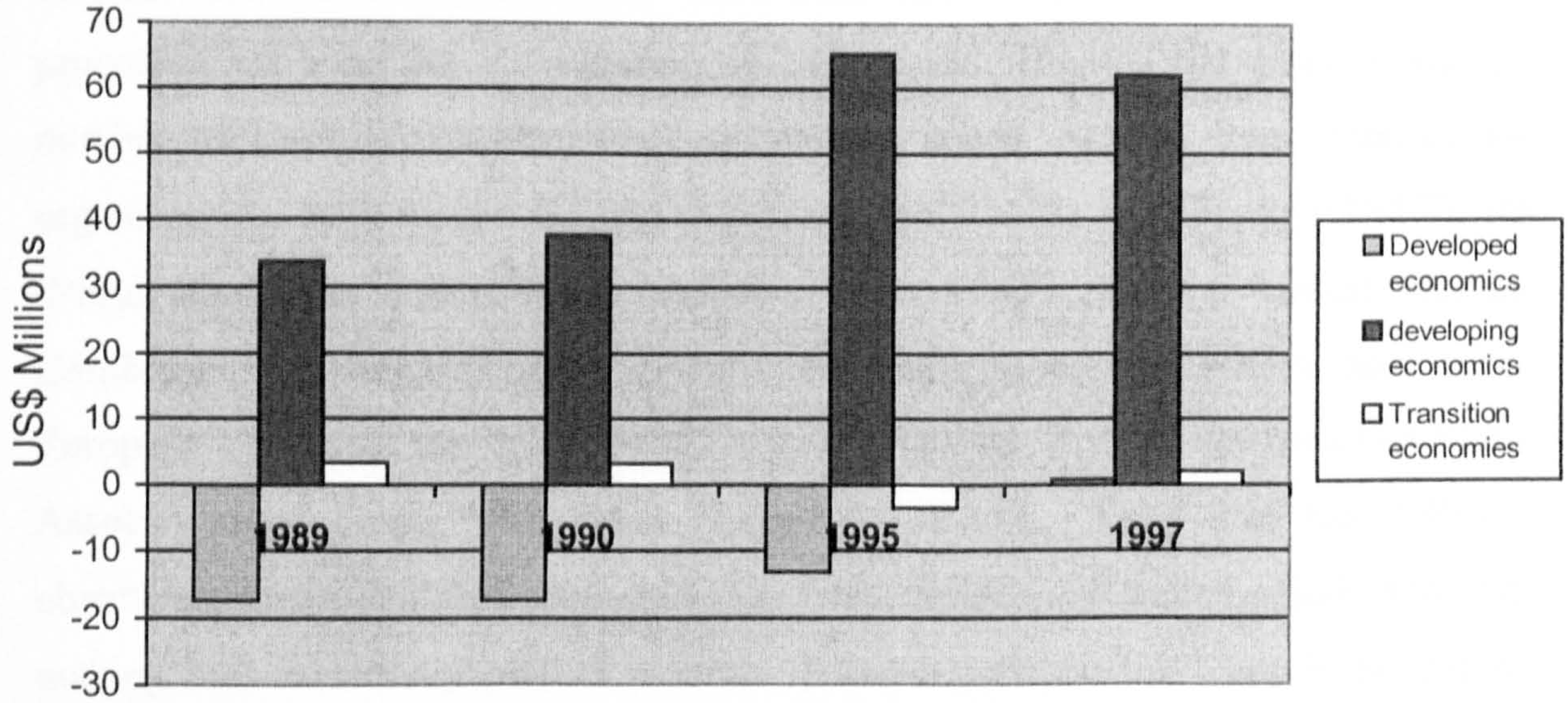


Figure 2.5: Travel Account Balance (1999)

Source: World Tourism Organisation, (WTO/OMT) (1999b)

2.3 THE MAGNITUDE AND GROWTH OF WORLD TRADE

The fifty-seven years, which have passed since the end of the Second World War, has been a period of extremely rapid economic growth. World trade has grown at an even faster rate than world output. This rapid growth in world trade has been one of the main causes of the growth in output. World output has grown at a faster rate than in any other period in history. During the last one and a half-decades, output growth has been much slower. Nevertheless, the growth rate is still quite high in comparison with other equivalent periods in history.

According to Grimwade (1989), the rapid growth in international trade has been the result of an increase in the degree of international specialisation, especially in the manufacturing industry and between industrialised economies. The rapid growth of world trade relative to world output has meant an increase in the degree of international economic integration; the world has become much more of an interdependent whole. In all the industrialised countries the size of the trading sector as a proportion of national output has increased. Important changes have also taken place in the nature and pattern of world trade.

Another feature of international trade associated with the internationalisation processes has been the globalisation of institutions. Beyond the national state, a number of intergovernmental institutions have arisen ranging from international organisations, such as the General Agreement on Tariffs and Trade (GATT), the World Bank, the International Monetary Fund (IMF) and the United Nations Conference on Trade and Development (UNCTAD), to regional groups, such as the European Economic Community (EEC), Latin America Free Trade Area (LAFTA), Association of South East Asian Nations (ASEAN). Each unit has different objectives, responsibilities, constituencies, time concern and power. Each decision-making unit is actually part of a larger decision process, but there is no central decision unit in the system (Meier, 1980).

On the other hand, according to the World Trade Organisation (1997a), the most significant development in the global economy has been the rapid growth of the services industries. Services account for the largest share of gross domestic product (GDP). Dicken (1992) argues that services are increasingly the major source of employment in all the developed market economies and in many developing countries as well. The services sector has been absolutely central to the economic growth of developing countries, a contribution, which is often overlooked, in the popular emphasis on manufacturing activities.

During the 1980s, international trade in commercial services accelerated to become an important driving force in the global trading system. The World Trade Organisation (1998c) states that the services sector has also been attracting an increasing share of world foreign direct investment, and now accounts for a larger share of foreign direct investment, for the leading industrialised countries as a whole, than manufacturing industries. Services are therefore, becoming increasingly internationalised.

2.3.1 REASONS FOR THE TREND TOWARDS MORE EXTENSIVE INVOLVEMENT IN INTERNATIONAL TRADE

The vigorous expansion of international trade since the end of World War II is attributable to a number of developments and circumstances. Among the more obvious and important of these factors are:

- Technological progress;
- Demographic trends;
- Economic growth;
- Improved political relationships among nations.

2.3.1.1 Technological Progress

The world has experienced a technological explosion during the past four decades, as new products and improved production processes have developed at a pace and in a variety unprecedented in history. This surge of innovations has had profound effects, both directly and indirectly, upon trade among nations, the most important being more specialisation in production, which forms a principal basis for international trade. Technological changes have also resulted in greatly improved transportation facilities and services, which has made it more feasible and less costly for goods to be moved physically from country to country.

Giant strides have also been made in communications technology, which has helped to spread awareness and knowledge of different products and consumer life styles throughout the world, while making it possible for business firms to communicate easily and quickly with customers and affiliates all around the globe.

With respect to tourism, it may be argued that the widespread use of information technology in tourism is a reflection of globalisation. Furthermore Kelly and Nankervis (1999) maintain that tourism is described as information intensive, with a clear need for communication among the various stakeholders-suppliers, intermediaries and travellers, plus more peripheral interests such as government bodies, tourism associations, consultants, researchers and educators.

For developing countries, technology is a critical factor for their ability to participate in world trade and for achieving sustainable development (UNCTAD, 1996b). The prospect for the technological progress of developing countries is determined by the availability of technology, including advanced technology, a proper enabling environment and the development of their human resources.

2.3.1.2 Demographic Trends

Over the past several decades, the number of people in the world has been growing so rapidly as to cause widespread concern. The world's population, which was approximately 2.5 billion in 1950, reached 4.7 billion in 1983 and reached 6.5 billion by 1999 (World Bank, 1999b). Such rapid growth raises serious questions as to the adequacy of the world's economic resources and productive capacity to provide for so many people, and it has created a demand for all kinds of economic goods and services.

2.3.1.3 Economic Growth

The overall growth of economic output and the resulting improvement in incomes and living standards that have been realised in much of the world comprise another set of causes of the post-World War II build up in international - trade. The positive economic trend has generated a strong effective demand for consumer goods and for the industrial materials and capital equipment needed to produce them. At the same time, economic growth is the main motivation for expanding the tourism industry.

2.3.1.4 Improved Political Relationships

Both the willingness and the ability of residents of different nations to carry on trade are heavily dependent upon the political relationships between nations and their respective governments. The period after the World War II has been characterised by co-operative international efforts to reduce governmentally imposed barriers to trade as part of a broad program of economic reconstruction and development. One significant manifestation of that was the adoption in 1947 of the General Agreement on Tariffs and Trade (GATT) which is directed toward the encouragement and support of international trade. As a result of GATT, there has been a gradual but substantial dismantling of the maze of governmental restrictions on trade that existed during the 1930s and 1940s.

2.3.2 DEFINITION OF INTERNATIONAL TRADE

According to Weekly and Aggarwal (1987), international trade consists of the exchange of goods and services among individuals and organisations that are residents of different nations. The trade constitutes the oldest form of international business, as people and commercial enterprises have exchanged goods and services across political boundaries ever since such boundaries were established.

The fundamental reason for conducting trade has always been the expectation of mutual economic benefits to the parties involved in such exchange, and economic theory has certified the potential for such benefits for nations that trade with one another. Baumol and Blinder (1991) summarise the main reason for why nations trade with one another and state that it is to exploit the many advantages of specialisation. "Specialisation means that a country devotes its energies and resources to only a small proportion of the world's productive activities" (Baumol and Blidner, 1991, P. 370).

In general, international trade is essential for the prosperity of the trading nations because:

- Every country lacks some vital resources that it can get only by trading with others.
- Each country's climate, labour force and other endowments make it a relatively efficient producer of other goods.
- Specialisation permits larger outputs and can therefore offer economies of large-scale production.

Meier (1980) argues that although international economic relations are wide-ranging, most of the important policy issues fall in to place within three major problem areas:

- Trade and welfare;
- Trade and stability;
- Trade and development.

Each of these problem areas lends itself to three types of analysis:

- Theoretical;
- Empirical;
- Normative.

The first problem area appears in the operation of the General Agreement on Tariffs and Trade (GATT). The body of theory is corresponding to this first problem area classical and neo-classical trade theory. It begins with Adam Smith's (1776) refutation of mercantilist regulations, proceeds to David Richard's (1817) celebrated exposition of the doctrine of comparative advantage, which is consider the cornerstone of the new GATT (1994), and continues through Johnstuart Mill, Alfred Marshall, and more modern economists.

This theory is labelled "pure" in the sense of being the non-monetary theory of international trade in equilibrium. In determining relative prices and real incomes in international trade, it concentrates on the "real" non-monetary forces of trade, such as factor supply, productivity and technology, and establishes whether an equilibrium solution exists. Policy problems in this area have become more complex as an earlier generation's concern with "free trade" has had to accommodate recent demands for "fairer trade" and "orderly trade".

Trade and development pose many vital policy issues, and the debate over the connections between foreign trade and the economic development of developing countries has become increasingly lively. Unlike the other two problem areas, a distinct and substantial body of theory has not yet emerged to make analysis of this problem area feasible. Particular examples of the problems of trade and development are to be seen in national development plans of poor countries, foreign aid programs, policies with respect to transitional enterprises, the operation of the World Bank, and the demands of the United Nations and UNCTAD for a new international economic order.

2.4 TRENDS IN PRODUCTION AND GLOBAL TRADE

2.4.1 GLOBAL OVERVIEW

The years immediately following 1945 were obviously ones of basic reconstruction of war-damaged economies throughout the world (see table 2.7). It was to be expected that there would be considerable growth of production and trade during the 1950s as the world economy caught up after the deep recession of the 1930s and after the war itself. At the time it was felt that growth rates would then slacken in the 1960s (World Bank, 1986). Not only did such slackening not occur but rates of growth reached unprecedented levels. Between 1948 and 1953 world trade increased at an average annual rate of 6.7%; between 1953 and 1963 the rate had risen to 7.4%, and between 1963 and 1968 it had accelerated further to 8.6% (IMF, 1990).

Table 2.7: World Merchandise Trade by Region and Selected Economy (1948-97)

	1948	1953	1963	1973	1983	1993	1997
Exports (Billion dollars)							
World	**58.0**	**83.0**	**157.0**	**578.0**	**1835.0**	**3635.0**	**5303.0**
Percentage							
World	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
North America	27.5	24.6	19.4	17.2	15.4	16.8	17.0
Latin America	12.3	10.5	7.0	4.7	5.8	4.4	5.3
Western Europe	31.0	34.9	41.0	44.8	39.0	43.8	42.9
Transition economies	6.0	8.2	11.0	8.9	9.5	2.9	3.4
Africa	7.4	6.5	5.7	4.8	4.4	2.5	2.3
Middle East	2.1	2.1	3.3	4.5	6.8	3.4	3.1
Asia	13.8	13.2	12.6	15.0	19.1	26.3	26.0
Japan	0.4	1.5	3.5	6.4	8.0	10.0	7.9
Six East Asia traders	3.0	2.6	2.4	3.4	5.8	9.7	10.3
Other	10.4	9.1	6.7	5.2	5.3	6.6	7.8
GATT/WTO Members	60.4	68.7	72.8	81.8	76.0	87.0	89.9

Source: World Trade Organisation (WTO) (various issues)

Table 2.8: World Merchandise Trade by Region and Selected Economy (1948-97)

	1948	1953	1963	1973	1983	1993	1997
	Imports (Billion dollars)						
World	**66.0**	**84.0**	**163.0**	**589.0**	**1879.0**	**3743.0**	**5469.0**
	Percentage						
World	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
North America	19.8	19.7	15.5	16.7	17.8	19.9	20.1
Latin America	10.6	9.3	6.8	5.1	4.4	5.0	5.8
Western Europe	40.4	39.4	45.4	47.4	40.0	43.0	41.4
Transition economies	5.8	7.6	10.3	8.9	8.4	2.9	3.5
Africa	7.6	7.0	5.5	4.0	4.6	2.6	2.3
Middle East	1.7	2.0	2.3	2.8	6.3	3.2	2.6
Asia	14.2	15.1	14.2	15.1	18.5	23.5	24.2
Japan	1.0	2.9	4.1	6.5	6.7	6.5	6.2
Six East Asia traders	3.0	3.4	3.1	3.7	6.1	10.0	10.7
Other	10.2	8.8	7.0	4.9	5.7	7.0	7.3
GATT/WTO Members	52.9	66.0	74.2	89.1	84.0	91.2	90.0

Source: World Trade Organisation (WTO) (various issues)

Such growth rates grossly exceeded any previously experienced. A particularly important feature of the post war period was that trade increased more rapidly than production (output), and grew nearly twice as fast as world output, a clear indicator of the increased internationalisation of economic activities and of the greater interconnectedness which have come to characterise the world economy (see figure 2.6).

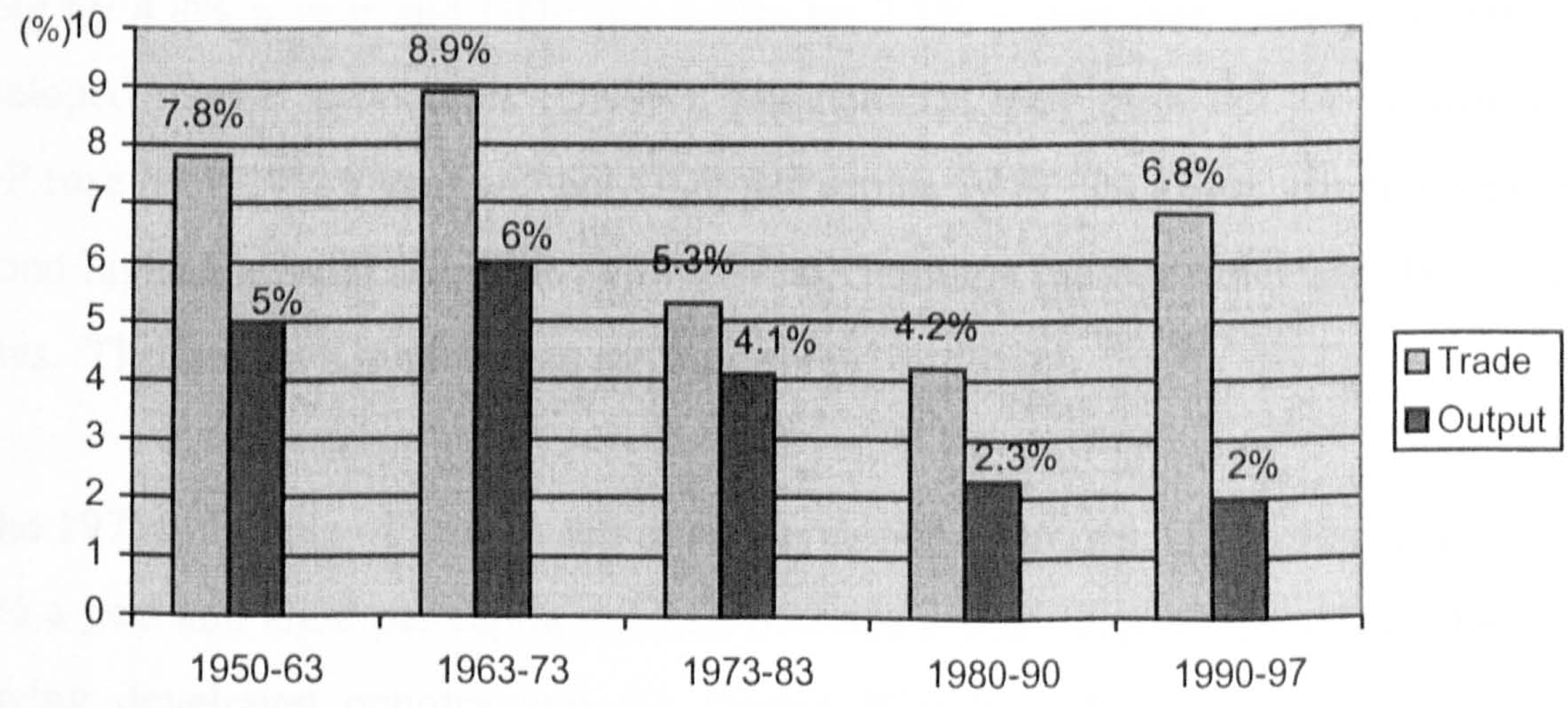


Figure 2.6: World Merchandise Trade and Output (1950-97)

Source: GATT, (various issues)

According to the World Bank (1995a), the growth in the volume of merchandise exports decelerated in 1990 to 4%, compared with 4.5% in 1989. This was mainly the result of the recession in Western Europe. In 1997, according to the WTO (1998c), the volume of world merchandise exports grew by 9.5%, the second highest rate recorded in more than two decades. World output grew at 3%, matching the best performance since 1989. WTO (1999j) shows that the rate of the growth in the volume of world merchandise exports slowed to 3.5% in 1998, due largely to continuing Asian crisis. World output growth slipped to 2% in 1998. Although trade growth still exceeded output growth in 1998, it was by a smaller margin than the average for the 1990s.

The developed markets output of goods and services were forecast to decline slightly from 2.5% in 1997 to 2.2% in 1998. Economies in transition registered a modest growth of 3.5%, while developing countries witnessed a drastic reduction from an estimated growth rate of 6% in 1997 to 3.8% in 1998. Pressures of the recession in East Asia caused a fall in the growth of output in emerging and developing economies.

In contrast with the 1990s, the period between the early 1950s and early 1970 was one of almost continual growth in world production and trade, with only minor and short-lived interruptions. It can be seen from the UNCTAD (1987) figures that the developed market economies enjoyed the fastest growth in the 1960s with GDP rising by 4.8% a year and GDP per capita by 3.8% a year (see table 2.9). Of the developed market economies (DMEs), Japan had a very high rate of growth; her GDP rose by 12.4% a year and her GDP per capita by 11.3% a year. France had the second highest growth rate followed by West Germany (at that time) and the United States. The Untied Kingdom had the lowest rate of growth.

In the 1970s, the rate of growth fell in all developed countries. GDP grew at a rate of 3.3% a year and GDP per capita at a rate of 2.4% a year. Japan was still the fastest-growing developed country and the Untied Kingdom the slowest growing, the immediate cause of the slow down was the oil crisis of 1973 to 1974. It began with an oil embargo imposed by the Middle Eastern states on countries supporting Israel in the October War (Grimwade, 1989). The resultant shortage of oil enabled the oil producing countries that belonged to the Organisation of Petroleum Exporting Countries (OPEC) to enforce a quadrupling of the world price of oil which drastically cut real incomes in the western industrialised countries depending on the Middle East for imported oil. The fall in real incomes caused a fall in demand for domestically produced goods and services and a slump in output.

According to UNCTAD (1987), in 1960 the developing countries achieved a faster rate of GDP growth than the developed countries at a rate of 59% a year compared with 4.8% a year for the DMEs. However, because they also experienced rapid population growth, GDP per capita increased by only 3.2% a year compared with 3.6% a year for the DMEs (see table 2.9), the GDP per capita of developing countries in 1982 was barely one tenth of that of DMEs. Thus developing countries need to grow at a faster rate than developed countries merely to prevent widening in the gap in per capita incomes.

Table 2.9: Annual Average Rates of Growth of GDP by Region (1960-1983)

Year	Developed economies (%)	Developing economies (%)	Transition economies (%)
1960-70	4.8	5.9	6.7
1970-80	3.3	5.1	5.3
1970-75	3.5	5.7	6.2
1975-76	4.9	7.2	5.8
1976-77	3.9	5.4	4.9
1977-78	4.0	2.8	4.6
1978-79	3.4	5.4	2.4
1979-80	1.4	1.8	3.1
1980-81	1.7	-0.2	2.4
1981-82	-0.2	0.5	3.0
1982-83	2.3	-0.1	4.2

Source: UNCTAD (1985)

The early 1970s delivered a severe shock to economies, as growth rates of both production and trade declined with each decade (GATT, 1992). World trade grew only slightly faster than world output. The rise in world oil prices plus the rise in other primary commodity prices had a beneficial effect on economic growth in certain developing countries in the mid-1970s. On the other hand, the non-oil producing developing countries were damaged by the rise in oil prices.

According to Grimwade (1989), a number of developing countries were able to ride out the first oil crisis by borrowing from western banks awash with funds deposited by the oil exporters. This explains why the developing countries were able to maintain reasonably fast growth in the early 1970s, at a time when the developed countries were experiencing a slow down.

The major economic sector driving the upsurge in both international production and especially international trade was the manufacturing industry. As Figure 2.7 shows, world trade in manufacturing has generally outperformed world production in manufactures through out the period from the 1950s. The share of manufacturing in world merchandise trade increased dramatically, from 52% of the total in 1963 to 73% in 1988 (World Bank, 1995a). The WTO (1997a) indicates that the share of manufacturing in world trade reached 78% in 1996. In fact, manufacturing has played a dominant role in increasing the share of world production traded internationally.

The UNCTAD (1987) explains that this growth of trade in manufacturing was made possible by the gradual lowering of tariffs on trade in manufactured goods and the removal of other quantitative restrictions in the quarter century since the ending of the war. This was achieved through the establishment of the GATT in 1947 and the various GATT tariff-cutting rounds in subsequent years.

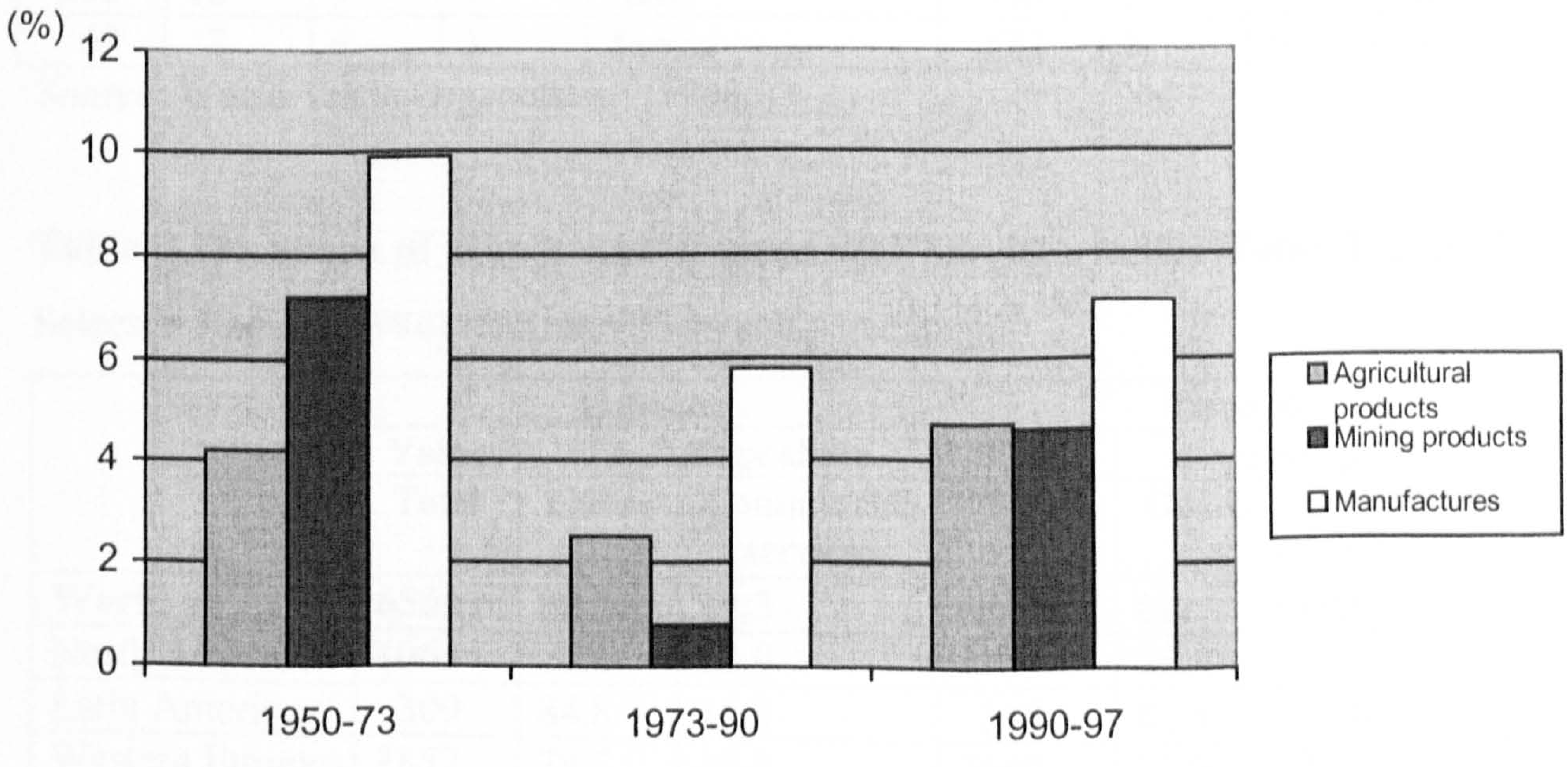


Figure 2.7: Average Annual Change in World Merchandise Trade by Major Product (1950-97)

Source: World Trade Organisation (1998c)

2.4.2 GLOBAL SERVICE ECONOMY

On the other hand the service sector plays an important role in world trade. Services production is a core economic activity in virtually all countries, developing and developed alike. During 1980 the growth of international trade in commercial services accelerated. In the 1970s such trade grew more slowly than manufacturing trade but during the 1980s commercial services trade increased more rapidly. In 1970, commercial services constituted 24% of the total and by 1987 its share had grown to 40%, and the share had increased to 67% in 1997 (WTO, 1998d).

Table 2.10: Growth in Value of World Trade in Commercial Services by Selected Region (1990-1997) (Billion dollars and percentage)

Exports					Imports			
Value	Annual percentage change				Value	Annual percentage change		
1997	90-97	1996	1997		1997	90-97	1996	1997
1310	8	7	3	World	1295	7	5	2
259	8	9	7	North America	186	6	7	6
51	8	5	9	Latin America	66	10	7	18
598	5	4	1	Western Europe	557	5	4	-1
531	5	5	0	European Union (15)	516	6	3	-1
28	6	8	3	Africa	39	5	0	8
298	12	9	5	Asia	356	10	7	2
68	7	4	3	Japan	122	5	6	-5

Source: World Trade Organisation (1998c)

Table 2.11: Share of Goods and Commercial Services in the Total Trade of Selected Region (1996) (Billion dollars and percentage)

	Exports			Imports		
	Value	Percentage share		Value	Percentage share	
	Total	Goods	Commercial services	Total	Goods	Commercial services
World	6580	80.7	19.3	6460	80.4	19.6
North America	1062	77.1	22.9	1153	84.8	15.2
Latin America	309	84.8	15.2	317	82.4	17.6
Western Europe	2852	79.2	20.8	2659	78.9	21.1
Africa	152	82.3	17.7	155	76.8	23.2
Asia	1733	83.6	16.4	1641	80.0	20.0

Source: IMF (1998c)

According to the World Bank (1997b), service industries have increased their share of the world economy during the past two decades, while the relative share of agriculture and industry shrank in most developing regions. Compared with about 55% in 1980, this sector contributed almost two-thirds of global GDP in 1996, and one-fifth of the value of world exports. Developing countries' exports of services grew at an average annual rate of 12% in the 1990s, twice as fast as those from industrial regions (World Bank, 1997b).

While production by multinational firms is becoming increasingly important in manufacturing, the impact of global service industries in developing countries is still small, concentrated in finance, communications, and leisure industries. Even so, deregulation and the opening of sectors such as telecommunication, tourism and utilities to foreign investors are speeding the process of globalisation (World Bank, 1997b).

According to the WTO (1999h), over the past 15 years, international trade in services grew significantly faster than merchandise trade. While trade in merchandise increased at about 6%, services trade expanded at an annual rate of 8% between 1980 and 1995. As a result, the services share in world trade rose from 16 to 18% over the same period. By 1998 Commercial service recorded the first annual decline in dollar value since 1983. All the three major service categories (i.e. transport, travel and other commercial services) saw a decrease. Exports of goods and commercial service both decreased slightly but at $ 5225 and $1290 billion respectively, but were still above the levels reached in 1995 (see table 2.12).

Table 2.12: World Exports of Merchandise and Commercial Services (1995-1998) (Billion dollars and percentage)

	Value				Annual change			
	1995	1996	1997	1998	1995	1996	1997	1998
Merchandise	4915	5150	5325	5225	20.0	4.5	3.5	-2.0
Commercial services	1200	1275	1320	1290	15.0	6.7	3.5	-2.0

Source: World Trade Organisation (WTO) (1998c)

According to the EC (1998c), world trade in commercial services, measured on a balance of payments basis, accounted for around one-fifth of world exports of goods and services, which reached US$ 6.5 trillion in 1997. Total exports of commercial services in the world were estimated to be US$ 1.3 trillion in 1997. In value terms merchandise exports amounted to US$ 5.3 trillion in 1997 and commercial services to US$ 1.3 trillion in 1997. In 1998 the commercial services decreased slightly due to the economic crisis in Asia (see table 2.13).

Table 2.13: World Exports of Commercial Services by Selected Region (1990-97) (Billion dollars and percentage)

	Value	Share		Annual percentage change			
	1997	1990	1997	90-97	1995	1996	1997
World	**1310**	**100.0**	**100.0**	**8**	**15**	**7**	**3**
North America	**259**	**19.7**	**19.8**	**8**	**11**	**9**	**7**
United States	230	17.3	17.5	8	11	8	7
Latin America	**51**	**3.7**	**3.9**	**8**	**7**	**5**	**9**
Mexico	11	0.9	0.9	6	-5	12	5
Brazil	8	0.5	0.6	11	25	-4	37
Western Europe	**598**	**52.9**	**45.6**	**5**	**15**	**4**	**1**
European Union (15)	531	47.0	40.5	5	15	5	0
United Kingdom	85	6.8	6.5	7	15	7	12
France	80	8.4	6.1	3	11	-1	-3
Germany	75	6.5	5.7	6	27	5	-4
Italy	72	6.2	5.5	6	16	6	4
Africa	**28**	**2.4**	**2.1**	**6**	**10**	**8**	**3**
Egypt	10	0.6	0.7	10	7	10	6
South Africa	5	0.4	0.4	5	12	3	11
Asia	**298**	**16.8**	**22.7**	**12**	**18**	**9**	**5**

Source: World Trade Organisation (WTO) (1998c)

Table 2.14: World Imports of Commercial Services by Selected Region (1990-97) (Billion dollars and percentage)

	Value	Share		Annual percentage change			
	1997	1990	1997	90-97	1995	1996	1997
World	**1295**	**100.0**	**100.0**	7	16	5	2
North America	**186**	**15.4**	**14.4**	6	9	7	6
United States	150	12.0	11.6	6	10	7	7
Latin America	**66**	**4.2**	**5.1**	10	5	7	18
Brazil	19	0.8	1.5	16	34	6	36
Mexico	12	1.2	0.9	2	-27	11	16
Western Europe	**557**	**48.4**	**43.0**	**5**	**16**	**4**	**-1**
European Union (15)	516	43.3	39.8	6	16	3	-1
Germany	120	9.7	9.3	6	21	1	-5
Italy	70	6.1	5.4	5	17	3	5
United kingdom	69	5.5	5.3	6	11	7	9
France	62	6.2	4.8	3	15	2	-5
Africa	**39**	**3.3**	**3.0**	**5**	**10**	**0**	**8**
Egypt	7	0.4	0.6	12	-16	4	52
South Africa	6	0.5	0.5	6	19	-8	4
Asia	**356**	**22.0**	**27.5**	**10**	**21**	**7**	**2**

Source: World Trade Organisation (WTO) (1998c)

According to WTO (1998c), the transportation and travel business accounted for more than 50% of exports of commercial services in 1997. Table 2.15 shows that the share of transportation and travel business in world trade in services in 1997 was about 24.4 and 32.8% respectively, which indicates the increasing importance of tourism in international trade.

Table 2.15: World Exports of Commercial Services by Sector (1997)
(Billion dollars and percentage)

	Transportation	Travel services	Others
Value in 1997 US$ bn	320	430	560
Annual percentage change (%)			
1990-97	5	7	9
1995	13	15	16
1996	2	7	9
1997	2	1	6
Share in world exports of commercial services	24.4	32.8	42.9

Source: International Monetary Fund (IMF) (1998a)

Table 2.16: Share of Commercial Services by Sector in Total Trade of Commercial Services by Region (1997) (%)

	Transportation		Travel services		Others	
	Exports	Imports	Exports	Imports	Exports	Imports
North America	21.6	29.6	36.3	34.8	42.2	35.7
Latin America	24.4	42.9	49.4	30.0	25.7	27.1
Western Europe	24.2	26.7	31.2	31.2	44.6	42.0
European Union	24.3	26.6	31.0	30.9	44.7	42.5
Africa	26.7	39.1	44.6	22.8	28.7	38.1
Asia	25.1	30.9	27.7	27.4	47.2	41.7

Source: World Trade Organisation (WTO) (1998c)

2.4.3 INTERNATIONAL TRADE BY REGION

2.4.3.1 Developed Market

- **Western Europe**

According to the World Bank report (1994-95), Western Europe in the early 1990s accounted for 43% of world merchandise imports and about 44% of world exports.

It is clear that a major factor behind the deceleration in the growth of world trade was the recession in that region, which caused the regions demand for merchandise imports to decline 2.5% in volume terms. In value terms, the region's imports in 1993 fell by almost 10.0%, as a result of the combined effects of the recession on intra- regional trade and the valuation effects of the US dollar's appreciation (see table 2.17).

The decline in intra-regional trade, which in 1993 accounted for almost 70% of Western Europe's US$ 1.6 trillion of merchandise exports and 25% of world merchandise exports, as also reflected in a 6.5% decline in exports. The less pronounced decline for exports compared with imports is mainly due to an acceleration of exports to Asian countries, with the exception of Japan (see table 2.17).

Table 2.17: Growth in the Value of World Trade by Region (1991-1993)

Exports					Imports			
Value	Annual changes				Value	Annual changes		
1993	1991	1992	1993		1993	1991	1992	1993
3640	1.5	6.2	-0.4	World	3730	1.7	6.2	-1.2
610	5.3	6.1	4.6	North America	743	-1.1	7.9	8.6
159	-0.9	4.7	5.9	Latin America	185	15.3	18.9	7.7
1601	-1.1	5.9	-6.5	Western Europe	1607	0.6	4.3	-9.9
1363	-0.7	6.3	-6.4	European Union (12)	1367	2.0	4.9	-10.4
211	-3.7	4.8	-6.9	EFTA	197	-5.5	1.0	-10.1
100	-18.1	2.7	4.1	Transition Economies	101	-23.2	-1.8	6.4
44	-13.9	6.3	-0.7	Central/Eastern Europe	56	-8.0	10.3	9.4
91	-2.3	-1.4	-5.8	Africa	94	-0.5	5.0	-5.9
124	-9.3	3.9	-0.7	Middle East	122	12.4	15.6	-5.4
956	10.5	9.1	-7.4	Asia	877	7.5	6.5	8.2
362	9.5	8.0	6.6	Japan	242	0.7	-1.6	3.6
92	15.9	18.2	8.0	China	104	19.6	26.4	29.2
354	12.4	8.5	8.8	Six East Asian countries	373	14.5	7.7	8.1

Source: World Bank (1995a)

In 1997 Western Europe's trade growth recovered strongly. The export recovery was most pronounced in Germany, France, Spain, Ireland and Turkey, which recorded double-digit growth. The depreciation of the ECU vis-à-vis the dollar, together with the relatively weaker domestic demand in continental Western Europe than in other regions, caused exports to continue to expand faster than imports.

Recent statistics from the World Trade Organisation in 1999 show that Western Europe experienced an import expansion, which, for the first time since 1992, exceeded the region's export growth rate. Western Europe was the only major region, to record an increase in the dollar value of its exports. Imports in value terms increased by 5%. The share of Western Europe in world merchandise trade recovered to 44% following the marked decrease that occurred between 1990 and 1997 (see table 2.18).

Table 2.18: Growth in the Value of World Merchandise Trade by Region (1990-1998)

Exports						Imports				
Annual percentage change						Annual percentage change				
90-95	1995	1996	1997	1998		90-95	1995	1996	1997	1998
7.5	**20.0**	**4.5**	**3.5**	**-2.0**	**World**	**7.5**	**19.5**	**5.0**	**3.0**	**-1.0**
8.5	14.5	6.5	9.5	-1.0	North America	8.0	11.0	6.0	10.5	4.5
9.0	22.0	12.5	10.0	-2.0	Latin America	15.5	11.5	2.5	16.5	0.5
6.0	23.0	3.5	-0.5	2.5	Western Europe	5.5	22.5	3.5	-1.5	5.0
6.5	23.5	3.5	-0.5	3.0	European Union	5.5	22.0	3.0	-2.0	5.5
7.0	27.0	6.5	5.0	-1.0	Transition economies	5.0	26.0	17.0	9.5	3.0
7.5	26.5	6.0	8.0	9.0	Eastern/Central Europe	11.5	28.0	17.0	7.0	11.5
0.5	13.5	16.5	2.0	-16.0	Africa	5.5	21.5	-1.0	6.0	-1.5
3.5	10.5	5.5	6.0	-15.0	South Africa	10.5	30.5	-1.5	9.5	-11.0
1.5	13.5	17.0	4.0	-21.0	Middle East	5.5	14.0	7.0	6.5	-6.0
12.0	18.0	0.5	5.5	-6.0	Asia	12.0	23.0	4.5	0.5	-17.5
9.0	11.5	-7.5	2.5	-8.0	Japan	7.5	22.0	4.0	-3.0	-17.5
19.0	23.0	1.5	21.0	0.5	China	20.0	14.0	5.0	2.5	-1.5
14.0	23.0	3.0	25.0	-7.5	Six East Asian traders	15.0	26.0	3.0	0.5	-25.0

Source: World Trade Organisation (1999j)

Commercial service imports expanded by 4% in 1998 and commercial service exports by 3%. The UK and France are the largest exporters of commercial services and France and Italy are the largest importers of commercial services in Western Europe (see table 2.19).

Table 2.19: Gross Domestic Product and Trade in Goods and Services in Western Europe, 1990-97 (Billion dollars and percentage)

	Value	Annual percentage change in volume								
	GDP	Gross Domestic Product			Exports of goods and services			Imports of goods and services		
	1997	90-97	1996	1997	90-97	1996	1997	90-97	1996	1997
Western Europe	8703	1.7	1.8	2.6	5.8	5.0	9.5	4.5	4.2	8.3
European Union (15)	8095	1.6	1.7	2.6	5.9	4.8	9.4	4.5	3.9	8.3

Source: World Trade Organisation (WTO) (1998c)

- **North America**

Most rises in world economic growth in early 1990s were due to the acceleration of growth in the United States, which offset a decline in economic activity in the European Union and Japan. According to the UNCTAD (1994), exports in North America grew by 5.3% in 1991 and imports by 8.6%. In the sixth year of economic expansion (1990-1997), North America's GDP growth accelerated to nearly 4% in 1997, exceeding the expectation of many forecasters. The strength of overall economic activity was reflected in trade flows. Measured in constant prices, both exports and imports recorded double-digit growth for the second time in the 1990s.

The value of merchandise exports rose by 9.5% in 1997, three times faster than world trade. For the first time since 1994, North America's imports grew faster than exports to10% (see table 2.18). The strength of North America's import demand led to a sharp rise in imports from Western Europe (21.0 %), China (21 %) and Japan (14 %).

North America's trade performance in recent years has led to a recovery of the region's share in world trade. The share of the United States exports reached 17%, the highest level since 1970. As regards imports, the share was 20.1%, the highest level since 1987 (see table 2.20).

Table 2.20: Merchandise Trade of North America, 1997

(Billion dollars and percentage)

	Exports	Imports
Value	903	1101
Share in world merchandise trade	17.0	20.1
Annual percentage change		
Value		
1980-85	1	6
1985-90	11	8
1990-97	8	8
1995	15	11
1996	6	6
1997	9	10
Volume		
1980-85	-0.5	7.0
1985-90	8.5	5.0
1990-97	7.5	8.0
1995	9.0	7.5
1996	6.5	5.5
1997	11.0	13.5

Source: World Trade Organisation (WTO) (1998c)

North America's exports and imports of commercial services expanded less than merchandise trade, but still considerably faster than world services trade (IMF, 1997a). In value terms, exports of commercial trade in services in North America accelerated from US$ 99. 5 million in 1987 to US$ 259.0 million in 1997, which amounted for about 62 percent in 10 years time (see table 2.21).

Table 2.21: Commercial Trade in Services in North America, 1987-97

(Billion dollars)

	Exports	Imports
1987	99500	90900
1988	116200	101300
1989	135300	109000
1990	155100	125700
1991	171400	129400
1992	183900	132200
1993	186800	140900
1994	200400	151500
1995	223000	164600
1996	242700	175400
1997	259200	186100

Source: World Trade Organisation (WTO) (1998c)

2.4.3.2 Transition Economic Countries

The recent period of slow growth and recession in Western Europe in the early 1990s coincided with the continuing growth in central and Eastern Europe and the former USSR. The extent of trade reforms varies across the region but the common arrangement for trade and economic relations-the former Council of Mutual Economic Assistance (CMEA)-has all but disappeared.

Following the dramatic collapse of transition economies' traditional markets, governments in Central and Eastern Europe sought access to alternative markets for their exports. Most of the policy and institutional arrangements of the past have been either eliminated or circumscribed such as commodity bilateralism, price subsidisation and taxation and distorted exchange rates.

These changes have led to a fundamental shift in the pattern of trade in Central and East European countries away from regional trade partners to Western Europe, and principally the European Union.

In 1993, the European Union accounted for roughly one-half of the trade of Central and East European countries, compared to one third in 1990, and this shift has taken place almost entirely at the expense of intra-regional trade, and trade with the former USSR. A shift of a similar magnitude is not, however, evident for the states comprising the former USSR, where trade with Western Europe already accounted for almost one-half of the total in 1990.

The share of the region composed of Central and Eastern Europe and the former USSR in total West European imports remains relatively small at 3.5%, and this assessment continues to hold if trade between members of the European Union is suppressed from the figures (about 12%).

The continued slide in trade which marked the early period of transition was brought to a halt in 1993, as in value terms, both the exports and imports of Central and Eastern Europe and the former USSR are estimated to have recovered in 1993. Of note is the expansion of exports and imports of the former USSR-a sharp contrast to the decline recorded in earlier years-which accounted for one-half of the region's trade in 1993. In addition, intra-regional trade partners participated in the 1993 trade expansion. However, the overall figures for the region mask significant disparities in terms of individual country performance.

In contrast, in 1997, the large variation in the trade and output performance of the transition economies reflects the uneven progress made in the reform process. The interaction between trade and output in the transition economies in recent years has been unique among the major regions. Strong and steady trade growth over the last three years has been felt (see table 2.22).

Table 2.22: Merchandise Trade of Transition Economies, 1997

(Billion dollars and percentage)

	Exports	Imports
Value	179	193
Share in world merchandise trade	3.4	3.5
Annual percentage trade		
Value		
1980-85	0	-1
1985-90	3	5
1990-97	7	7
1995	29	28
1996	7	14
1997	3	9
Volume		
1990-97	5.0	4.5
1995	14.5	15.0
1996	6.0	13.0
1997	10.0	16.0

Source: World Trade Organisation (WTO) (1998c)

Merchandise imports have expanded significantly faster than world trade in both real and nominal dollar values. Merchandise export growth, at 10% in volume terms, was the highest among all regions. However, due to the sharp decline in dollar export prices, the dollar export value of the region decreased slightly.

The commercial service trade of transition economies has been far less dynamic than merchandise trade in the last two years, with exports decreasing slightly and imports rising moderately. For central and Eastern Europe, an increase of 4% was recorded in 1997.

2.4.3.3 Developing Countries

Regional trade development was also influenced by commodity price developments in the 1990s, especially the sharp decline in prices for fuels (down 12%) and other minerals (down 16.0%) on world markets, combined with stagnant prices of food, beverages and tobacco. This principally affected the export earnings of countries heavily dependent on primary commodities, located mainly in Africa (including least developed countries) and the Middle East. As was noted earlier, it also affected the relative importance of primary product categories in relation to manufactured products, leading to declines in the shares of primary product categories in world merchandise trade (UNCTAD, 1994).

- **Africa**

Among the leading traders in Africa, export declines were broadly based with the exception of South Africa and Morocco, and import expenditures were correspondingly compressed. For the region as a whole, both exports and imports declined by 6% in 1993, a year which marked the third consecutive year of decline in exports values. This mainly affected trade with Western Europe, which accounts for 50% of Africa's exports and over one-half of the region's imports. Furthermore, the region's overall exports and imports in 1993 were in US dollar terms-just above the levels of decade ago.

In 1997, Africa's GDP and agricultural output growth slackened and nominal oil prices fell. Export earnings rose by 3% in dollar value terms, which is the world average rate but considerably less than the rate attained in 1996. Imports expanded to 6% % in 1997, sharply higher than the 1996 rate. Commodity price developments varied in 1997, with rises in the prices of beverages (coffee, tea and coca) contrasted with a fall in many food prices. Overall, price developments favoured many least developed African countries. A fall in wheat and rice prices has lowered the import bill of net food importing countries, at least to the extent that they relied on imports through commercial channels.

- **Middle East**

According to the World Bank (1995a), exports from the Middle East declined by 0.7% in 1993, and the decline in exports was broadly based across fuel exporters with the exception of Kuwait, where exports rose 5.8%. Import expenditures correspondingly reduced in many countries in the region, and in particular in Saudi Arabia. As a result, imports from the Middle East declined by 5.4% in 1993, a sharp reversal compared to the 16% rise recorded for 1992.

The Middle East region, more than 70% of whose exports are fuels, recorded a stagnation in the dollar value of its exports and imports, largely due to the changing fortunes of oil. After rising nearly 20% in 1996, spot crude oil prices fell by 6% on average in 1997. An increase in the region's oil export volumes partly offset the negative price effect on export earnings of lower oil prices. Both Africa and the Middle East have suffered the brunt of the decline in primary commodity prices in 1998. Despite a moderate recovery in Africa's GDP, linked to the recovery of agricultural output, -Africa's trade remained sluggish. Export values in the region decreased by 16% in 1998. Oil-exporting African countries recorded a decrease in exports exceeding one-quarter. Import values declined only slightly in 1998.

Available data on commercial services for Africa and the Middle East also indicated decreases in the value of both exports and imports. As was observed for merchandise trade, exports of services decreased faster than imports.

- **Latin America**

The most dynamic element in world merchandise trade developments in the early 1990s was the trade expansion of Latin America. Import demand accelerated by 10% in volume terms in 1993. In 1997, Latin America experienced an annual GDP growth rate of 5.2% and the largest net private capital inflow so far in the 1990s. Latin America's merchandise exports rose in real terms by about 13%, while merchandise imports surged by more than 20%. For both exports and imports, the 1997 performance was the strongest in the 1990s. The two largest traders in Latin America in 1997 were Mexico and Brazil, which continued to record double-digit trade growth.

In contrast, Latin America's GDP and trade growth slowed sharply in 1998 from exceptionally high levels recorded in 1997. The World Trade Organisation (1999j) states that the falling commodity prices, a slowdown in private capital inflows in the second half of 1998 and weaker export markets within the region and in Asia, contributed to this development. The growth in the volume of merchandise imports for the region in 1998 continued to exceed that of merchandise exports by a large margin, and the region trade expansion-both imports and exports- remained stronger than the global average. On the other hand, Latin America's merchandise exports value decreased by 2% in 1998. Latin America's outstandingly strong import growth performance throughout the 1990-97 period became less dynamic in 1998, although at 5%, this region, together with Western Europe, recorded the highest import growth rate of any region (see table 2.23).

Table 2.23: Merchandise Trade of Latin America (1997)

(Billion dollars and percentage)

	Exports	**Imports**
Value US$ bn	279	319
Share in world merchandise trade %	5.3	5.8
Annual percentage change		
Change in Value (%)		
1980-85	0	-7
1985-90	6	9
1990-97	10	15
1995	22	12
1996	12	11
1997	10	18
Change in Volume (%)		
1980-85	5.5	-6.5
1985-90	5.0	6.0
1990-97	9.0	13.0
1995	12.0	4.5
1996	11.0	11.5
1997	11.5	21.5

Source: World Trade Organisation (WTO) (1998c)

It appears that trade in commercial services has also grown rapidly. This growth was well above the global average, but less dynamic than the region's merchandise trade growth. Exports and imports of commercial services are estimated to have expanded by 4 to 5% in 1998.

Table 2.24: Leading Exports of Commercial Services in Latin America
(Billion dollars and percentage)

	Value	Share		Annual percentage			
	1997	1990	1997	90-97	1995	1996	1997
Latin America	51.3	100.0	100.0	8	7	5	9
Mexico	11.2	24.8	21.8	6	-5	12	5
Brazil	7.9	12.7	15.5	11	25	-4	37
Colombia	4.0	5.3	7.8	15	6	9	7
Chile	3.6	6.1	7.0	11	13	5	9
Argentina	3.1	7.8	6.1	5	11	14	2
Dominican republic	2.3	3.7	4.4	11	9	12	-
Bahamas	1.6	5.0	3.1	1	2	2	1
Venezuela	1.5	3.8	3.0	5	5	-6	6
Costa Rica	1.5	2.0	2.9	14	9	-	-
Uruguay	1.5	1.6	2.9	18	-1	6	6
Peru	1.4	2.5	2.8	11	10	27	9
Paraguay	1.4	1.7	2.8	17	14	1	0
Jamaica	1.4	3.3	2.8	6	8	-1	4
Netherlands	1.4	3.9	2.8	3	20	-14	0
Panama	1.4	3.0	2.9	6	11	6	3

Source: International Monetary Fund (IMF) (1998a)

2.4.3.4 Asia

Trade in the Asian countries especially the least developing countries, declined in the early 1990s, mainly due to less exports of mining and agriculture products. In 1991 Asian countries have enjoyed the highest performance since the end of the 1980s, as exports increased by 10.5%. On the other hand, Asian countries experienced a sharp decline in their exports to –7.4% the worst decline in 1990s.

In 1997, not only did economic growth slacken in Asia, particularly in Japan, the region's major market, but changes in major exchange rates (especially the rise of the dollar vis-à-vis the yen) caused concerns in regard to the competitiveness of East Asian developing countries. These countries, which had closely linked their currencies to the US dollar, were the most dynamic traders in the world over the previous decades. Exchange rate development, together with sluggish intra-Asian trade, as measured in dollar terms, added to the erosion of confidence of foreign investors.

The IMF (1998a) states that, despite slowing growth in Japan and the countries hit by the financial crisis, the Asian region managed a real import growth rate of 5.5% in 1997. Exports recovered strongly in comparison to 1996 and at an 11.5% growth rate, expanded faster than world trade. In dollar terms, Asia's exports expanded by about 5.5%, while imports stagnated. Japan, China and the Asian developing countries that suffered from financial crisis all experienced higher export growth than import growth. Within the latter group of countries, trade growth varied considerably in 1997. The Philippines recorded strong export and import growth, while Malaysia's trade stagnated in dollar terms. Imports from Indonesia, the Republic of Korea and Thailand declined.

In 1998, Asia recorded the strongest import contraction in volume and value terms of all regions. Import volume decreased by about 8.5% under the impact of Japan's import contraction of 5.5%, and that of the Asia (5) of more than 20%.

In 1998, Asia (5) imports contracted by one-third and those of Japan by 17%, only certain-South Asian countries recorded a slight increase in their imports (e.g. India, Sri Lanka). The trade performance of most Asian countries improved in the last quarter of 1998, partly due to the strengthening of the yen and other Asian currencies vis-à-vis the dollar.

The turn around in private capital flows and the associated drop in domestic investment and consumption levels largely explain the sharp import contraction in the Asian (5) countries (almost one-third in value terms). The decrease in exports of the Asia (5) countries, however, was stronger than expected even if one takes in to account the high share of intra-regional trade in total trade. Despite the strong currency devaluation's that boosted the price competitiveness of enterprises in the Asia (5) countries, the combined exports of these countries did not increase their market shares in the major developed markets. In fact, China's exports to the United States, Japan and major European markets expanded faster than those of the Asian (5) countries in 1998. Commercial service exports of Asia increased faster than global trade, while service imports remained unchanged from the previous year.

2.5 THE IMPORTANCE OF INTERNATIONAL TOURISM IN INTERNATIONAL TRADE

Tourism has become one of the most important industries for many countries and brings with it significant economic impacts. According to the World Trade Organisation (1998c), tourism ranks in the top five export categories for 83% of countries, notably in Europe, the Middle East and the Americas and is the leading source of foreign exchange in at least one in three developing countries.

According to the UNCTAD (1998a), the world tourism industry has grown at double the pace of Gross Domestic Product (GDP) over the last 30 years. It is regarded as the world's largest industry and one of the fastest growing, accounting for over one-third of the value of total worldwide trade in 1997. Statistics provided by the World Tourism Organisation emphasise the economic significance of tourism at the global level. International tourism receipts grew faster than world trade (commercial services and merchandise exports) in the 1980s and now constitutes a higher proportion of the value of world exports than all sectors.

In 1997, according to the World Tourism Organisation (1999b), tourism receipts accounted for a little over 8% of total world exports of goods and almost 34% of the total world exports of services (see table 2.25).

Table 2.25: Tourism Receipts Compared to World Exports of Merchandise and Commercial Services (1995-1997) (Thousands of millions of dollars and%)

	Value			Yearly change %		
	1995	1996	1997	1995	1996	1997
Merchandise	4.915	5.125	5.295	20.0	4.0	3.0
Commercial services	1.200	1.270	1.295	15.0	6.0	2.0
International tourism receipts	405	436	436	14.5	7.5	0.1

Source: World Trade Organisation and World Tourism Organisation (1998c)

The global tourism industry (including transport) generated an estimated output of US$ 3.8 trillion in 1997 (UNCTD, 1998d). According to the World Bank (1997b), tourism receipts are accounted for 6.4% of global -wide exports, and international tourism expenditures accounted for 6.3% of global imports. In 1999, the tourism share in world trade has increased; international tourism receipts accounted for 8% of world exports, which indicates that tourism is growing faster than other activities (World Bank, 1999b).

The UNCTAD (1998f) states that the positive economic impact of tourism is felt in terms of foreign exchange earnings, tax revenues, investments and job creation. These positive effects, however, can be counteracted by the remittance of foreign exchange earnings abroad, and by an inability to deal with the effects of man-made and natural disasters.

International trade in tourism services provides employment for over one hundred million people world-wide, and the WTO predicts that by the year 2005, tourism jobs will increase faster than traditional industries by as much as 59%. Tourism also generates value-added and tax revenue, and attracts investment and foreign currency, since the sector boasts strong multiplier and spill-over effects. The dynamism of tourism is expected to continue outpacing in economic growth in the future, driven by globalisation, economic expansion in developing countries and countries in transition, structural and demographic change in developed countries and, recently, by the liberalisation brought about by GATS.

In many economics, the travel and tourism sector has for some time been recognised as a major area of activity. This activity draws on the resources of those economies and affects their nature and development. Additionally, governments have increasingly seen fit to use tourism as an instrument of macro-economic policies. Tourism often has a high involvement in policies related to employment levels or the balance of payment, whose significance in modern macro-economic management is high.

According to the World Travel and Tourism Council (WTTC) (1999) tourism and general travel accounted for 10.7% of world-wide GDP in 1996, 11.7% in 1999 (see table 2.26).

Table 2.26: The Travel and Tourism Economy (1999)

1999 Estimates	Gross Domestic product		
	US$ Billion	% of total	Growth
World	3,549.9	11.7	3.0
Africa	45.8	8.8	5.6
North Africa	19.7	6.8	6.0
Sub-Sahara Africa	26.2	11.2	5.2
Americas	1,289.5	11.1	2.8
North Americas	1,170.8	11.8	2.5
Latin Americas	90.0	5.6	6.1
Caribbean	28.6	20.6	5.5
Asia/Pacific	712.6	10.0	3.6
Oceania	67.8	14.7	3.8
Northeast Asia	536.9	10.0	2.8
Southeast Asia	81.4	10.6	5.5
South Asia	26.5	5.3	9.1
Europe	1,460.8	14.0	2.6
European Union	1,262.7	14.1	2.3
Other Western Europe	103.1	15.4	3.8
Central and Western Europe	95.0	11.1	4.8
Middle East	41.3	7.3	5.2

Source: World Travel and Tourism Council (WTTC) (1999)

Traditionally, trade in the tourism services has been concentrated in the developed countries. As shown in table 2.26, the share of North America and the European Union in the GDP growth, as an example of the developed countries, has accounted for the highest share among all the countries (For North America 11.8% of and European Union 14.1%).

On the other hand, the share of developing countries in total world tourism has risen slowly to almost one third of the total (UNCTAD, 1998g). Several developing countries have succeeded in expanding their tourism service exports by adopting clear tourism development policies, investing heavily in the sector and co-operating at regional and sub-regional levels. For many of them tourism is a fundamental source of income and foreign exchange and one of the few development opportunities available, particularly for the least developed countries and island countries.

According to UNCTAD (1998j), tourism is the only major sector in international trade in services where developing countries have consistently had surpluses. Their positive balances in the travel account improved steadily from US$6 billion in 1980 to US$62.2 billion in 1996. It more than doubled during the second half of the 1980s, driven by the growth of inbound tourism to countries in Asia and the Pacific and in Africa. Such progress is due to many factors:

- Massive targeted investment;
- Promotion policies;
- Marketing efforts.

Table 2.26 shows Africa as an example of developing countries that has recorded the highest growth rate from 1998 to 1999; 5.6%, followed by the Middle East with 5.2%. Egypt, despite its recent problems, is the leading country, with nearly 35% of total growth.

In 1999, travel and tourism accounted for 8% of total employment worldwide (World Trade Organisation, 1999i). Table 2.27 shows the travel and tourism employment in 1999. The world average was accounted for 8.2% of total worldwide employment. Oceania has recorded the highest share of employment with 16.0% of total, followed by the Caribbean with 15.8%.

Table 2.27: The Travel and Tourism Employment (1999)

1999 Estimates	Employment		
	MN Jobs	% of total	Growth
World	**192.3**	**8.2**	**2.6**
Africa	**11.8**	**7.4**	**3.3**
North Africa	2.2	7.4	2.8
Sub-Sahara Africa	9.6	7.4	3.4
Americas	**33.8**	**9.6**	**2.0**
North Americas	21.2	11.9	1.4
Latin Americas	8.9	6.0	3.4
Caribbean	3.6	15.8	1.9
Asia/Pacific	**96.9**	**6.7**	**3.3**
Oceania	2.1	16.0	1.9
Northeast Asia	57.2	7.1	3.0
Southeast Asia	15.3	7.3	4.7
South Asia	22.3	5.4	3.3
Europe	**47.8**	**13.2**	**1.0**
European Union	22.1	14.5	0.5
Other Western Europe	4.4	15.6	1.9
Central and Western Europe	21.3	11.7	1.3
Middle East	**2.0**	**6.1**	**3.2**

Source, World Travel and Tourism Council (WTTC) (1999)

Tourism provides both direct and indirect employment. Companies that provide direct employment are those whose employees are in contact with the tourists or directly affect the tourist experience. Companies that provide direct employment include hotels, food services operations, airlines, cruise lines, travel agencies, attractions and shopping outlines.

Companies that provide indirect employment in the tourism industry are those that serve the direct employment companies. These indirect employment companies, which may be restaurant suppliers, construction firms that build hotels, and aircraft manufacturing, are dependent on the companies providing direct employment for their revenue. Overall, direct and indirect employment in tourism represents a sizeable portion of total employment. As shown in table 2.28, both direct and indirect employment opportunities in tourism are expected to grow over the next decade.

Table 2.28: Travel and Tourism Employment (1991-2005)

Year	Direct Employment % of Total	Indirect Employment % of Total	Total
1991	4.9	5.3	10.2
1994	5.1	5.5	10.6
2005	5.4	5.9	11.3

Source: World Tourism Organisation (WTO) (1998e)

According to World Tourism Organisation (1998) for each job created in the tourism industry, some five to nine jobs are generated in other areas. WTO/OMT predicts that by the year 2005, tourism jobs will increase faster than traditional industries by as much as 59% and it will account for 11.3% of total employment.

Considering the highly labour-intensive nature of tourism, developing countries and least developed countries would appear to have a strong potential comparative advantage. Besides generating million of jobs worldwide, the tourism industry in 1994 had a payroll of US$1.7 trillion, or 10.3% of total employment wages and salaries.

2.6 THE RISE OF THE DEVELOPING WORLD

One of the most striking features of the economic environment of the past two decades has been the extent of trade liberalisation in developing countries. Consequently, the developing world has had an increasing role to play in the WTO (World Trade Organisation) and its agreements, as the power and enthusiasm of its trade have increased. This fact was the primary force shaping the evolution of the Uruguay round.

According to the OECD (1995a), the post-war era has seen a shift in economic gravity from the West towards the East. And recent economic reforms in Latin America and Eastern Europe have shifted power still further away from the OECD economies. Indeed, over the past few years, growth in world trade has been increasingly dominated by the so-called developing world. A fundamental change in attitudes in the developing world towards freer trade and co-operation with foreign firms have underlines this shift.

Around 100 countries in all parts of the globe have under taken unilateral trade reforms of one form or another. Some of these have been voluntary; most have been promoted by the two key multilateral lending agencies, the World Bank and IMF. Both have lending programmes where loan advances are conditional on policy reform and trade policy is a favoured target. The reason for the emphasis on reform of trade policy is quite simple: a belief that liberalisation is conducive to growth (Dixon, 1998). But is it? This question will be discussed in next chapter.

The World Bank (1999b) illustrates the importance of trade to developing countries and argues that there are four reasons which should be considered:

- First, it is frequently the primary means of realising the benefits of globalisation. Countries win when they gain market access for their exports and new technology through international transfers, and when heightened competitive pressure improves the allocation of resources.

- Second, the continuing reallocation of manufacturing activities from industrial to developing countries offers ample opportunity to expand trade not only in goods, but also in services, which are becoming increasingly tradable. In a few decades, global trade in services may well exceed that in goods.

- Third, trade is intertwined with another element of globalisation: the spread of international production networks. These networks break up sequential production process, which traditionally has been organised in one location, and spread it across national borders. This dynamic force will result in further geographic dispersion of production and increase trade among cities, regions, and countries.

- Fourth, the growth of trade is firmly buttressed by international institutions of long standing. The World Trade Organisation (WTO), built on the legacy of the General Agreement on Tariffs and Trade (GATT), is the latest step in creating a commercial environment more conducive to the multilateral exchange of goods and services. The GATT and the WTO have served as the means of securing past gains through multilateral trade liberalisation. But more important, the WTO can function as the point of departure for future rule making to promote still greater openness of trade. If trade is to continue expanding as rapidly as it has in the past, and if it is to be of greater benefit to developing countries, the international community must engage in further liberalisation and institutional reforms.

2.7 TOURISM SUPPLY AND ITS MARKET STRUCTURE

Tourism supply is a complex phenomenon because of both the nature of the product and the process of delivery. Tourism has specific characteristics that set it apart from the more general goods in the market place. An understanding of the complexity of tourism as a service product is an essential prerequisite for understanding why tourism services need to liberalise. Principally it cannot be stored, cannot be examined prior to purchase, it is necessary to travel to consume it, heavy reliance is placed on both natural and human-made resources and a number of components are required, which may be separately or jointly purchased and which are consumed in sequence. It is a composite product involving transport, accommodation, catering, natural resources, entertainment and other facilities and services, such as shops and banks, travel agents and tour operators. Many businesses serve other industrial sectors and consumer demands, thus raising the question of the extent to which suppliers can be considered as primarily suppliers of tourism.

According to Cooper et al (1998), the tourism industry is an interdependent industry. This means that firms purchase not only primary inputs such as labour and inputs, but also intermediate goods and services produced by other establishments within the local economy. Therefore, a change in the level of final demand for one sector's output will not only affect the industry that produces that final good or services to that sector and the sectors that act as suppliers to these sectors as well.

Bull (1998) adds that the major feature of tourism supply activity is the heavy preponderance of fixed costs. For example, resort hotels such as the Hyatt Regency Resort in Hawaii have a heavy property investment with fixed financing costs, and facilities such as golf courses, swimming pools, tennis courts, stables and health clubs as well as ongoing marketing and administrative overheads.

The many components of the product, supplied by a variety of businesses operating in a number of markets, create problems in analysing tourism supply. It is therefore, convenient to consider it as a collection of industries and markets and to examine it using not only the neo-classical paradigm but also other schools of thought.

This approach lows the analysis not only to cope with the complexity of the tourism product but also to take account of developments in economic concepts, theories and methods, especially the orientation of supply analysis towards industrial economics and the issues with which it has been concerned.

The main objective in this section is to explain the supply side of the tourism product, which will help to study the explanation of the tourism sector in international trade and help to measure the comparative advantage of a country.

2.7.1 MARKET STRUCTURES IN TOURISM SUPPLY

The problem with any classification of the supply components of tourism is how broad or narrow they should be. Such categories as transport and accommodation are very broad and benefit from desegregation into sub-markets with different structures and modes of operation.

Discussion of tourism supply has been conducted largely, many texts discussing financial structure, management, marketing, quality and training and they go further to the planning, development, operation and performance of such enterprises as hotels, guesthouses, holiday villages, ski and timeshare resorts and theme parks as components of tourism supply.

The approach adopted here is to follow the classifications, which have been recognised in the tourism literature (For example, Cooper, 1998, Holloway, 1994) (see table 2.29).

Table 2.29: Major Tourism Markets

Accommodation	Serviced Self-catering
Transport	Air Rail Road (coach & car hire) Sea
Intermediate	Travel agents Tour operator
Attractions	Natural Human-made
Other services	Private Public

2.7.2 THE ACCOMMODATION SECTOR

Accommodation is the largest and most ubiquitous sub-sector within the tourism economy. The accommodation sector is central to international tourism, according to Vellas and Becherel (1995), tourism flows are directly influenced by the size of the accommodation sector, by the way it adapts to demand and by the quality of the accommodation on offer.

Tourists require a location where they can rest and revive during their travels through, or stay within. In the context of the tourism sector in general accommodation rarely has a place or rationale in its own right. It is rare for a tourist to select to stay in a hotel or other form of accommodation for its own sake. Rather, the choice is made because the accommodation provides a support service for the wider motivation, which has brought the visitor to the destination, whether for business or leisure purpose. Of course, there are exemptions from this argument. Holloway (1994) explains that the tourist might choose to stay at a specific resort (as the case of Greenbriars or Gleneagles) because of the accommodation experience that such hotels provide.

Many elements are included in the accommodation and catering sector. There is great diversity in the size, type and organisation of this accommodation. According to Jones and Pizam (1993), this diversity ranges from:

- Accommodation that provides for one or two guests in simple, home style, to "bedroom factories" with capacity to cater for up to 5000 guests;
- Accommodation in a very basic, functional form, or in extreme luxury and opulence;
- Ownership can be private and informal, or accommodation may be provided with within units operated by major multinational organisations.

In shorts, accommodation is characterised by extreme heterogeneity.

2.7.3 THE STRUCTURE OF THE ACCOMMODATION INDUSTRY

2.7.3.1 Chains

In the economic analysis of international tourism, a hotel must be differentiated from other forms of lodgings used by tourists. Thus, a hotel is a commercial establishment offering rooms or furnished apartments to a market. It may offer catering services, bars and complementary services (Vellas and Becherel, 1995).

Hotel groups can operate hotels in a number of ways. Some hotels are owned outright by groups, whilst others are leased. In some cases groups can act as an agent, operating the hotel for an independent owner and charging a management fee for their services. Other arrangements include the management of hotels on behalf of independent owners in return for a share in the profits. Harrison (1992) states that the reasons for hotel chains not owning the hotels they operate lies in the fact that large investments may initially be required for land and building.

There are two main kinds of hotel chains:

- Hotel consortia: Independent hotels are grouped together by hotel consortia, in order to compete with integrated and franchised chains.
- Integrated hotels: Integrated chains and commercialised hotel products that are consistent and homogeneous. They exert their control either directly, by complete ownership of the hotel, or indirectly, through a franchise system or a management contract. All hotels in the chain carry the name and insignia of the chain.

2.7.3.2 Franchising

Hotel franchising is largely responsible for the expansion of the integrated hotel chain sector. Franchising brings its standards, its brand name, its experience and its reputation. The franchise company is a commercial enterprise and the hotelier is both a client and an associate. The company contributes its technical expertise and financial help to set up the investment and it assists the franchisee's management by putting the marketing services and computerised central reservation system at its disposal. The franchise company will give support in publicity campaigns and provide advice on management matters and equipment purchasing.

Moreover, the person or company who buys the franchise pays for knowledge, advice and assistance in establishing the business. Most importantly however the franchisee is paying to use the well-known brand name. The other main benefit is that the costs of advertising, promotion and reservations are shared between a large number of hotel units.

2.7.4 ECONOMIC CHARACTERISTIC OF ACCOMMODATION SECTOR

Notwithstanding its complicated structure, Sinclair and Stabler (1998) state that some fundamental economic factors characterise the accommodation sector:

- It is subject to fixed capacity with all its attendant problems in the face of periodicity.
- Perishability: Accommodation production cannot be stocked, accommodation products that are not consumed cannot be stored for use at a further date.
- Seasonality: Its economic activities are seasonal which implies a great flexibility in structures.
- Manpower planning: The industry is labour intensive, which further compounds the problems caused by seasonality. It requires accurate forward planning of temporary employment.

Allied to this, particularly in larger units offering a wide range of services, high fixed costs drive operators to attain high occupancy rates through such devices as product differentiation and market segmentation. These characteristics tend to involve elements of both natural monopoly and oligopoly. For example, some hotels concentrate on the luxury segment while others serve a budget clientele. Many seek flexibility by targeting the business market during the working week and the leisure sector at weekends. In holiday resorts, the needs of different groups can be met over the year, for instance, catering for skiers in winter and walkers in the summer, as occurs in Austria, France and Switzerland.

There is evidence that some forms of accommodation can exploit economies of scale not only within individual establishments but also by the management of a large number of hotels, such as Choice Accor, Bass and Fort/Granada, the four leading international groups. To an extent it also accounts for concentration in the sector, the nature of ownership and location being other explanatory variables. Some large accommodation groups also attempt to enlarge their market share and control not only by take-overs and mergers but also by franchising, leasing, management contracts and collaborative agreements. Economic integration between firms may result in reduced fixed costs and entry barriers and may make it possible to increase occupancy rates by tapping new segments of the market. Large firms form cooperative consortia to reduce overheads, for instance, by setting-up referral or reservations systems. Large corporate-run hotels, mainly serving business travellers, tend to cluster in or around large urban areas, airports and on land transport routes.

Holiday hotels are more likely to be independent and more widely dispersed, although clustering still occurs, such as in resorts or locations which are principal tourist attractions. The accommodation sector is akin to monopolistic competition in the retail market, in which accessibility and complementarily, central tenets of urban economics, are characteristics.

Urban economic theory shows that key location confers benefits which give a commercial advantage and therefore a higher turnover and profits, explaining why large firms can outbid smaller ones in high cost areas like seaside resorts where smaller, lower quality hotels are pushed into secondary locations away from the sea front. This is explained in terms of spatial rent/property price gradients whereby, for individual businesses, location is determined by the property/ land costs each faces which are dictated, in turn, by the demand for specific sites by competing activities. Around airports, in urban centres and along seafronts, land costs are high whereas further away they are lower as demand for sites is less.

Thus businesses with lower revenue and profits are forced into areas with lower rents/prices. However, although the intensity of competition is lower in particular destinations outside locations subject to such clustering, it is still significant in terms of the total market, given the number of holiday choices open to consumers and the size and quality range of accommodation available. For example, in the summer sun package market there is a large number and wide distribution of destinations and types of accommodation so that, in the face of static demand, the market structure is highly competitive.

2.7.5 SELF CATERING ACCOMMODATION

The self-catering sector is an interesting area of the accommodation market, which has shown both high growth rates and great diversity. It has complemented the serviced sector by providing additional rooms whose clients are allowed use of the facilities provided, and it has also been incorporated into purpose-built or redeveloped tourism centres offering many attractions and facilities. Holiday centres and villages and timeshare come into this category.

There are a number of large players in the field, for example in the UK, Butlins, Haven, Holimarine, Pontins and Warners, formerly low-cost concerns which have upgraded their product, while the Centre Parcs Organisation is an innovative market leader. Disney Vacation, Hapimag, Vacation International, Villa Owners Club and timeshare are similar in terms of the holiday centre concept but differ in that they involve capital investment by consumers. However, none of these control the market, which displays two principal economic features. The first is the wide range of standards of quality and therefore segments of the market targeted. The second is its relative infancy, making it difficult to predict its eventual characteristics and competitive structure.

The picture that emerges of the holiday accommodation is of a fragmented sector dominated numerically by small and medium-sized business, even if not in terms of the value of total market transactions. This is largely the result of its relatively low entry barriers and generally labour-intensive nature, where the emphasis is on customer service within a small market area, owing to the spatial separation of both demand and supply. Thus, the market exhibits characteristics, which reflect more than one form of economic classification, ranging from highly competitive conditions in the small unit sector in clustered locations, to a virtual monopoly of specific locations by large hotels. However, the appropriateness of the neo-classical analysis of tourism accommodation is put to the test by its segmentation and temporal and spatial dimensions. Consequently, two branches of economic analysis appear to be pertinent to understanding and explaining the accommodation market. Industrial economics' concern with market structure, entry conditions and concentration, product differentiation, segmentation and spatial competition is certainly relevant. Urban and regional economics, with the focus on the determinants of location and spatial distribution of activity, can also make a contribution.

Overall, taking account of the significance of spatial factors in moderating market conditions, on a continuum of perfect competition to monopoly, the market structure of tourism accommodation tends to accord with the contestable-monopolistic competition positions. In business and resort centres, large hotels experienced oligopolistic conditions but outside these areas the structure is closer to monopolistic competition. The picture is clouded somewhat by the intra-sectoral choice of type and quality of accommodation with some segments, for example self-catering, being more contestable than others. The lack of empirical evidence precludes making further inferences.

2.7.6 TRANSPORT SECTOR

Transport is one of the most important prerequisites for the development of any destination. It is an essential element of the tourist product in two ways: It is the means to reach the destination and it is necessary as a means of movement at the destination. Increasingly, as transport is viewed as part as leisure, the journey is at least as important as the destination itself. For some categories of visitor, the trip is therefore seen as an attraction in its own right and certainly part of the tourist experience. For example, the Palace on Wheels (India), the Blue Train (South Africa) and the Nile cruises (Egypt).

Moreover according to Vellas and Becheral (1995), the cost of transport often determines the total cost of tourism products and directly influences the choice of tourism destination.

2.7.6.1 Mode of Transport

The most obvious way of analysing transport is by mode to denote the manner in which transport takes place. There are four major modes of travelling:

- Road;
- Rail;
- Water;
- Air.

According to Cooper et al (1998), the choice of mode of transport is related to the purpose of travel. In general, the tourist's choice of mode of transport is affected by:

- Distance and time factors;
- Status and comfort;
- Safety and utility;
- Comparative price of services offered;
- Geographical position and isolation;
- Range of services offered;
- Level of competition between services.

Given the wide range of transport modes, each possessing its own particular features and competitive characteristic and structure, transportation is best examined as a number of sub-markets (Sinclair and Stabler, 1998). For example the main commercial modes of air, bus/coach, ferries and rail suffer problems arising from indivisibility and associated fixed capacity and high fixed costs, periodicity and seasonality. Nonetheless, there are considerable differences in their respective market structure and conditions. Their relative importance also differs in terms of the numbers of passengers carried, revenue generated and the degree of substitution possible. For international travel, air far outstrips bus/coach, sea and rail. Air travel has shown extremely high rates of growth since the 1960s, fed by technological change with potential for continued growth in the future.

Car ferry operations have benefited from the introduction of roll-on-roll-off vessels. Bus, coach and rail traffic had experienced relative decline in the face of the growth of private motoring.

The structure and competitive conditions of transport sub-markets are strongly influenced by the interrelationship between certain modes and the severity of the constraints imposed by regulations. There is also competition within modes, such as in the airline sector, where there is fierce competition for many short-and long-haul routes. Similar circumstances apply in the bus and coach market. In the ferry market, high volume routes tend to be subject to keen competition. There is a significant symbiotic relationship between.

For instance, air travel depends on both bus/coach and rail for transfers to and from airports. Likewise sea crossing relies on road and rail transport for a large proportion of their traffic while the cruise-liner market is now largely based on air travel to and from the point of departure of the vassal. If the car hire sector is included, it is clear that it is dependent on airlines for much of its trade, often negotiating fly-drive packages as a means of increasing business. This complementarily, while it is an important feature of the transport market, does not suggest that there is not intense competition within and between modes.

With respect to competition between modes, the opening of the Channel tunnel linking the UK and France has demonstrated the fierce competition of ferry and rail although the merging of some ferry operations raises the possibility of an oligopolistic market structure. In some European countries, on domestic routes, rail and air travel are in competition, especially where the rail system has been updated for high-speed trains. Bus and coach travel and rail also compete, the former offering a low cost alternative to the latter's shorter travel times.

Regulation of transport has occurred for two main reasons, safety and the preservation of a market for a national or state-owned or supported mode. Interest in the impact of regulation has centred more on deregulation with the aim of fostering greater competition. However, it has become apparent, as will be shown, that such an action often has unintended and opposite effects, as has been manifested in air and bus/coach transport. Moreover, the extent of regulation varies even within a specific mode. Again, in air transport, part of the market is more strictly controlled than others, creating considerable variations in competitive situations.

2.7.7 INTERMEDIARIES

Youell (1998) states that the term "travel intermediary" is given to any individual or organisation that makes travel arrangements on behalf of a third partly, providing a link between customers and the suppliers of travel products and services, as shown in figure 2.8.

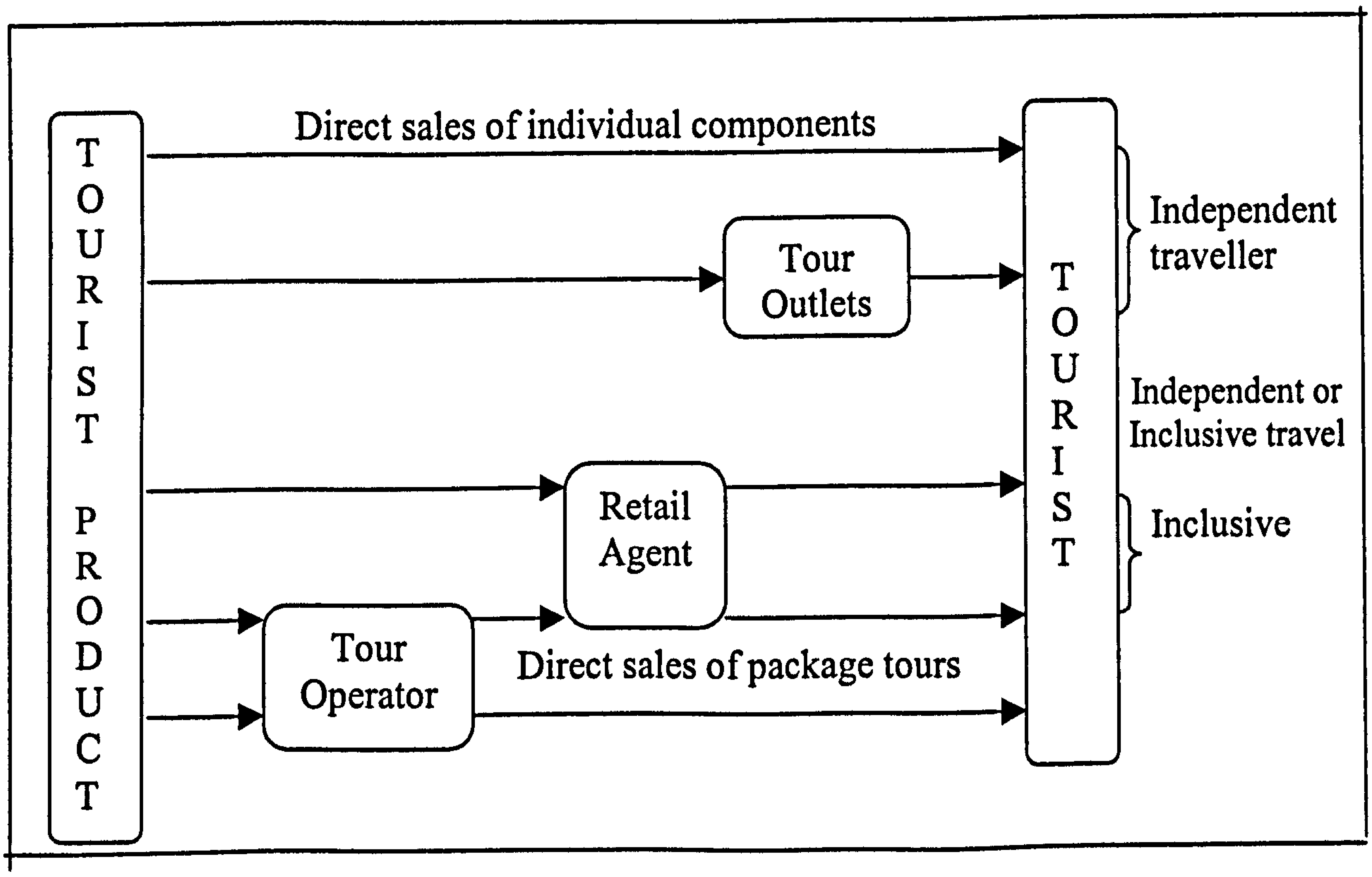


Figure 2.8: Structure of Distribution Channels

Source: Cooper et al, 1998, p. 249

The suppliers of travel products and service, include many firms that operate in the core sectors of the tourism industry and include hotels and other accommodation providers, transport companies, tourist attraction and destination marketing organisations. Travel intermediaries' liase directly or indirectly with such suppliers in order to satisfy the needs of their customers.

The very diverse nature of the international tourism industry means that there is a wide range of organisations that make travel arrangements on behalf of others, including transport companies, conferences organisers, business executives, youth group organisers, religious institutions, sports clubs and associations, charities and community group leaders. However, in terms of volume sales, by far the two most important intermediaries in the international tourism industry are tour operators and travel agents.

2.7.7.1 Tour Operators

According to Vellas and Becherel (1995), tour operators are commercial tourism firms specialising in the manufacture of travel packages. They are quite different from travel agents whose main activity is to sell and market tourism products. Tour operators are wholesalers and travel agencies are retailers, most tour operators also acquire the legal status of travel agencies or associations who package and sell tourism products to their members.

Tour operators design and sell travel packages. They are most firmly established in the UK, the USA and Germany. They are also rapidly developing in other European countries and in Japan. In contrast to travel agencies, tour operators are large national and sometimes international companies.

Tour operators buy in bulk from the providers of travel services such as hotels and airlines, they break the bulk in to manageable packages and offer the finished product, the inclusive tour (IT), for sale via a travel agent or direct to the consumer. Figure 2.9 shows the role of tour operators and their position as intermediaries between the suppliers of travel product and travel agents.

According to Youell (1998), there are four principal types of tour operators found in the international tourism industry:

- Mass market operators: companies that sell high volumes of "packaged" products, primarily to overseas destinations, at relatively cheap prices.

- Specialist operators: enterprises that concentrate on a particular country or destination, a particular activity or specific type of tourism, e.g. cultural tourism, business tourism or sports holidays.

- Domestic operators: companies that provide a range of product geared to the needs of the residents of their own country.

- Incoming operators: companies that specialise in supplying holidays and other travel services solely for overseas visitors to a country.

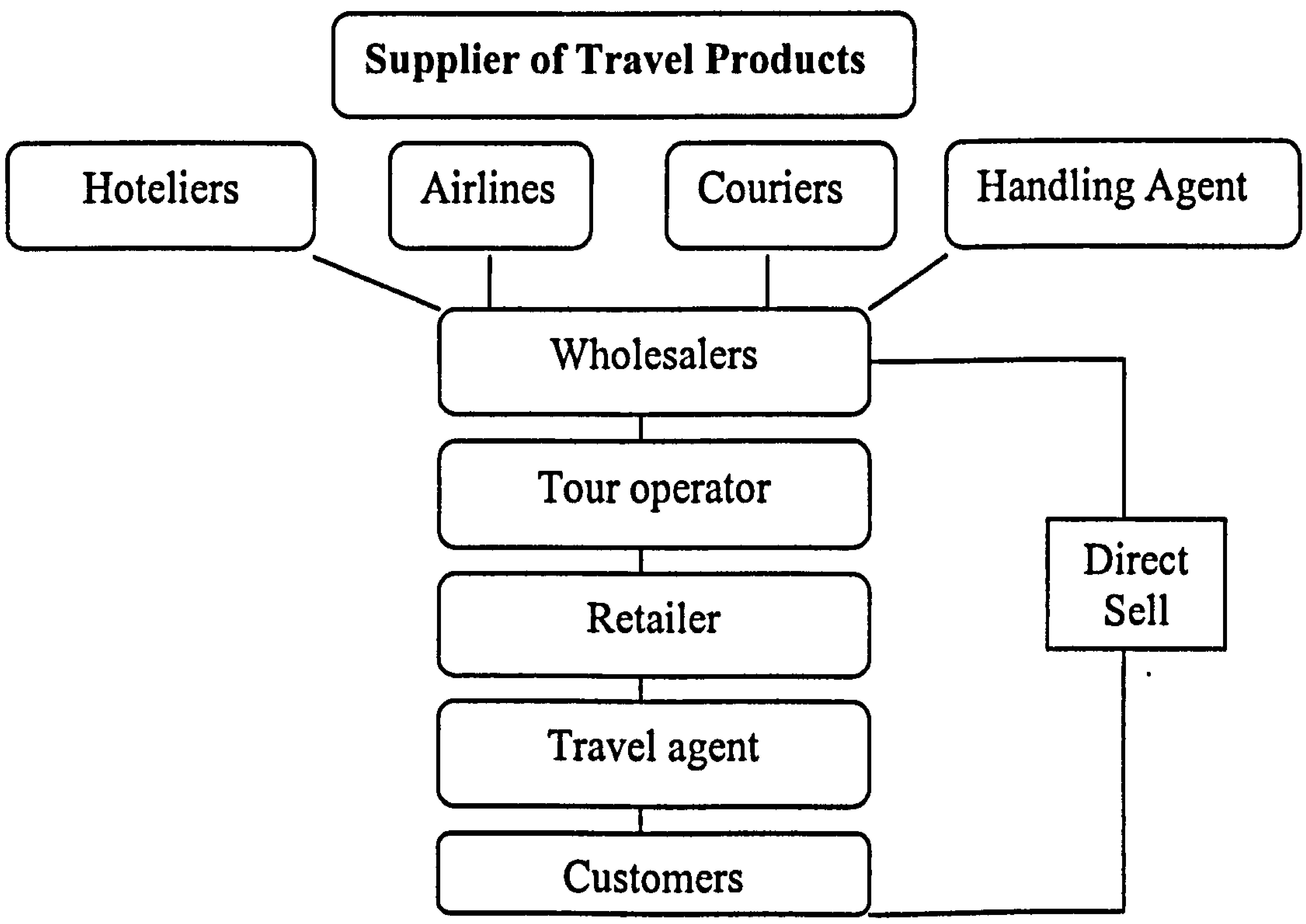


Figure 2.9: The Role of the Tour Operator

Source: Youell, 1998, p. 124

According to Cooper et al (1998), travel intermediaries bestow benefits on producers, consumers and the destination. These benefits include the following:

- Producers are able to sell in bulk and so transfer risk to the tour operator, though wholesalers do attempt to cover themselves by including release clauses in agreements. These may vary from four or more weeks to seven days.

- Suppliers can reduce promotion costs by focusing on the travel trade, rather than consumer promotion, which is much more expensive.

- By being able to purchase an inclusive tour, the traveller can avoid search and transaction costs in both time and money.

- Consumers gain from the specialist knowledge of tour operator and the fact that the uncertainties of travel are minimised. For example, cruising and coach tours are attractive to senior citizens because the holiday starts the moment they board the ship or coach.

- The most significant gain for tourists is lower prices, notably in the case of resorts dealing with large numbers of visitors as in the Mediterranean, Mexico and Hawaii. In such destinations wholesalers are able through their buying power to negotiate discounts of up to 60% off the normal tariff.

- Destinations, especially in developing countries may benefit considerably from the international marketing network of tour operators. However, it is naive to expect, as some countries do, that this should be the responsibility of these companies.

Sinclair and Stabler (1998) state that the performance of tour operators is very sensitive to market conditions, particularly variations in demand arising from such factors as changes in exchange rates, economic recession in origin countries and inflation and perceived political instability in destinations. In the face of tourism development and the continuing extension of possible destinations, capacity has sometimes outrun demand. Furthermore, as in the hospitality market, seasonality is significant. Large firms rely on a high volume of sales with low margins, a significant proportion of profit being generated by investing receipts from advanced bookings. A high rate of sales makes it possible to achieve substantial economies of scale and scope through operating efficiencies, a wide knowledge of an extensive market and market power to gain large discounts from carriers and hoteliers, where past performance is the key.

In the inclusive package market there is intense competition to secure sales volume in order to generate cash flows. Consequently discounting can be widespread at the launch of the subsequent season's packages to encourage early booking. Discounting can also occur at the end of the season to fill excess capacity. Discounting strategies are both a manifestation of the drive to maintain or increase market share and a reflection of the long lead times, often up to three years, required to launch new holiday types, increasing the likelihood of overestimating demand leading to over-supply. Even large companies indulge in price wars, the leaders in the market often initiating them to safeguard their market position.

As with the accommodation sector, the reality of the market is more complex than can be encompassed in any single theoretical model of market structure. It appears necessary, therefore, to consider different segments as being characterised by different competitive conditions. This, together with the apparent inherent instability, suggests an immature market, tends to show up the limitations of the neo-classical paradigm.

2.7.7.2 Travel Agencies

Travel agencies are essentially retailers, selling a tourism product, they act as agents for the tourism suppliers or principals. These principals may be a tour operator or wholesaler, a hotel, a transport company or other providers of travel and tourism product and services. An agent may also offer travel-related services such as insurance or foreign exchange. The travel agent achieves its income through the commission from the principals. The travel agent has access to the principal's stock through the reservation system, at this point the efficiency of the agent is important.

Cooper et al (1998) argue that the acquisition of product knowledge and the assumption of the risks involved in assessing the extent and nature of demand is the job of the agent. Many countries have national associations for travel agent that also act as regulating bodies: the Association of British Travel Agents (ABTA) in Britain and the American Society of Travel Agents (ASTA) in the USA.

As for tour operators economic of scale characterise the travel agency sector. With respect to spatial factors, an advantageous location is an important determinant of success, but this is offset by the costs of prime sites because of the competition to occupy these from not only other travel agents but also other forms of retailing. Nevertheless, spatial separation of travel agencies lessens competition and makes it possible for a firm to earn an adequate return on its investment.

Principals can potentially increase travel agency dependency and reduce competitors' impact by affecting the businesses that serve them, and the terms on which they do so, by utilising a system specific to their own operations as the only means of communicating with the company, for example Thomson's TOPS (Thomson Online Program System). Such practices not only constitute a restraint on trade, so acting against consumers' interests, but also increase agency costs because of the need to set up the means of accessing a number of systems. They also inhibit the long-run achievement of economies of scale by the agencies.

The issue of whether trade associations perpetuate restrictive practices or promote greater efficiency in the intermediary sector is problematic. Sinclair and Stabler (1998) state that those associated with travel agents have been able to secure as members a high proportion of those trading, largely because of the need to subscribe to schemes, such as bonds as a guard against the failure of tour operators, as a prerequisite for the procurement of a licence or to reassure customers. The American Society of Travel Agent (ASTA) and the Association of British Travel Agent (ABTA) are cases in point. Smaller businesses have also considered that these associations have given them a measure of protection, often by representing their interests to larger and powerful principals and public bodies. Of late, the function of these associations has been called in to question as the cost of membership and protective schemes has increased sharply. Thus, many facts of the intermediary market are of current interest in economics, in particular, the study of the competitive situation after the implementation of the GATS agreement.

2.8 SUMMARY

The chapter has examined the nature and determinants of international trade and international tourism. As discussed in the chapter, it is important to realise that international tourism is a major force of the globalisation of international trade-particularly in services. The significance of tourism as a source of income and employment and as a major factor in the balance of payments for many countries, has been attracting increasing attention on the part of governments, private sector entities, regional and local authorities, and others with an interest in international trade and economic development. If the barriers to worldwide travel were eliminated or reduced substantially, international trade in tourism services would increase dramatically.

The chapter also shows that tourism has specific characteristics that set it apart from the more general goods in the market place. An understanding of the complexity of tourism as a service product is an essential prerequisite for understanding why tourism services need to liberalise. The main objective in this section was to explain the supply side of the tourism product, which will help to study the explanation of the tourism sector in international trade and help to measure the comparative advantage of a country.

CHAPTER THREE

TRADE THEORY AND TOURISM LIBERALZIATION

3.1 INTRODUCTION

This chapter will briefly examine the development of trade theory, from the seventeenth century through to the first part of the twentieth century. This historical approach is useful not because the research is interested in the history of economic 'thought' but because it is a convenient way of introducing the concepts and theories of international trade, to justify why countries are involved in international trade.

Marsden, Adams and Crewdson (1980) in 'An Introduction to Comparative Economies' argue that the earth's resources are not equally distributed across the planet, and few countries are totally isolated, so few economies are 'closed'. Most need imports and in order to pay for these must export in return. International economics deals with the economic interdependence among nations, it analyses the flow of goods, services and payments between a nation and the rest of the world, the policies directed at regulating this flow and their effect on the nation's welfare. This economic interdependence among nations is affected by, and in return influences, the political, social, cultural and military relations among nations (Salvatore, 1983).

Competition among these nations takes place; the terms on which they compete are fashioned by the drivers of comparative advantage - factor endowment, factor productivity, technology and industrial competitiveness. These terms can also of course be influenced by government policy - tariffs, subsidies, quotas and so on, and these can impact on the competitiveness of individual countries firms and sectors (Greenaway, 1997). Specifically, international economics deals with the pure theory of trade, the theory of commercial policy, foreign exchange markets and the balance of payments, and adjustments in the balance of payments.

The pure theory of trade 'comparative advantage' which consider the cornerstone of the World Trade Organisation (WTO) and its agreements (e.g. GATT, GATS, TRIPS...), is the starting point for assessing international competitiveness for a given product or service. It analyses the basis for and the gains from trade. The theory of commercial policy examines the reasons for and the effects of trade restrictions. They are the microeconomic aspects of international trade economics because they deal with individual nations treated as single units and with the relative price of individual commodities.

According to Meier (1980), no economic policy issue has an older intellectual history of disputation than that of free trade versus protection. The pure theory or non-monetary theory of trade has been concerned with three central questions:

- What commodities will a country export and import under free trade?
- What determines the terms of trade 'ratio of exports prices to import prices'?
- What are the gains from trade?

This chapter begins with the first question and considers the determinants of the composition and direction of trade under free trade. So this investigates the various sources of trade: absolute advantage, comparative advantage, based on comparative labour productivity, comparative advantage, based on differential endowments of productive factors, and other sources of comparative advantage that are related to technological differences, economies of scale, and other dynamic phenomena.

3.2 ABSOLUTE ADVANTAGE

"The seed of modern international trade theory came from Adam Smith 1776" (Williamson and Milner, 1991, p. 20).

Smith started with the simple truth that for two nations to trade with each other voluntarily both nations must gain. If one nation gained nothing or lost, it would simply refuse to trade. Adam Smith developed the theory of Absolute Advantage through his recognition of the importance of specialisation and the division of labour.

This led him to advocate free trade, as two countries will benefit from trade if they can provide each other with a product or products more cheaply than they could be produced domestically.

According to Adam Smith, trade between two nations is based on absolute advantage. When one nation is more efficient than another in the production of one commodity, in other words (has an absolute advantage over), but is less efficient than or (has an absolute disadvantage with respect to) the other nation in producing a second commodity, that both nations can gain by each specialising in the production of the commodity of its absolute advantage and exchanging part of its output with the other nation for the commodity of its absolute disadvantage. By this process, resources are utilised in the most efficient way and the output of both commodities will rise. This increase in the output of both commodities measures the gains in production from specialisation available to be divided between the two nations through trade. The higher the level of specialisation, the greater will be the potential gain from trade.

Thus, while the mercantilists believed that one nation could gain only at the expense of another nation and advocated strict government control of all economic activity and trade, Adam Smith, and the other classical economists who followed him, believed that all nations would gain from free trade (Anderton, 1995). Free trade would cause world resources to be utilised most efficiently and would maximise world welfare.

3.3 COMPARATIVE ADVANTAGE AND THE PURE THEORY

Forty years after Smith, Ricardo (1817) published his principles of political economy, in which he presented the law of comparative advantage (Winters, 1985). This is one of the most important and still unchallenged laws of economies.

According to Salvtore (1983), Ricardo realised that absolute advantage was a limited case of a more general theory; he highlighted the problem involved in the theory.

That is, if a country has an absolute advantage in the production of all, or most, goods and services, then we are back at the mercantilist position. So, Ricardo showed that both nations could benefit from trade even in the situation where one of the countries has an absolute advantage in the production of all goods, by specialising in, and exporting the commodities in which it is relatively less efficient.

So that, under conditions of free trade, a country will specialise in the production and export of those commodities it can produce with greatest comparative advantage (e.g. those commodities for which its costs are comparatively low) and will import commodities in which it has a comparative disadvantage (e.g. those commodities it can produce only at high relative cost).

David Ricardo believed that all costs ultimately could be reduced to labour costs. This belief is known as the labour theory of value. Hence the price of goods could accurately be measured in terms of man-hours of production. Following on from this, he argued that differences in comparative costs reflected differences in the productivity of labour.

Anderton (1995) states that there is an element of truth in this idea. The theory suggests that high labour productivity countries would have a comparative advantage in the production of sophisticated high technology goods whilst low labour productivity countries would have a comparative advantage in the production of low technology goods. Looking at the pattern of world trade, it is true for instance that developing countries export low technology textiles, whilst developed countries export high technology computer equipment.

The principle of comparative advantage may be demonstrated by using the concept of opportunity costs. Grimwade (1989) states that this expresses the cost of something in terms of the opportunity foregone in order to obtain that something. That means the cost to a country of producing more of one commodity is the amount of another commodity, which is thereby foregoes.

To illustrate the meaning of comparative costs, Ricardo focused on a simple example of two countries, two commodities, and one factor of production; labour a **2 X 2 X 1** model (see table 3.1).

Table 3.1: Comparative Advantage

	USA	UK
Bushels of wheat/man hour	6	1
Yard of cloth/man hour	4	2

Source: Meier (1980)

In the USA, one hour of labour time produces six bushels of wheat but only one in the UK, on the other hand, one hour of labour time produces four yards of cloth in the USA and only two in the UK. The UK now has an absolute disadvantage in the production of both wheat and cloth with respect to the USA. However, since the UK labour is half as productive in cloth, but six times less productive in wheat with respect to the USA, the UK has a comparative advantage in cloth. On the other hand, the USA has an absolute advantage in both wheat and cloth with respect to the UK, but its absolute advantage is greater in wheat (6:1) than in cloth (4:2). The USA has a comparative advantage in wheat.

To summarise, the USA absolute advantage is greater in wheat and so it has a comparative advantage in wheat. The UK absolute disadvantage is smaller in cloth, so that its comparative advantage lies in cloth.

According to the law of comparative advantage, both nations can gain if the USA specialises in the production of wheat and exports some of it in exchange for UK cloth. (At the same time, the UK is specialising in and exporting cloth).

The principle of comparative advantage states that countries will benefit from specialisation whenever there exists a difference in comparative costs. A further requirement is that the international terms of trade (the ratio of the price of her export to the price of her imports) must fall between the two countries, pre-trade, relative prices.

Clearly, unless the UK can get a better price for her wheat and the US a better price for her cloth than the price, which they fetch on the home market, there will be no incentive to trade and no gain from trade. This shows that the terms of trade are important in determining how much each will gain from trade. The nearer the terms of trade to a country's pre-trade relative price ratio, the smaller the potential gains to a country from trade. In this case, most of the gains from trade would have occurred to the UK but still the US can gain from trade

To prove the law of comparative advantage it is necessary to show that the USA and the UK can both gain by each country specialising in the production of and export of the commodity for which it holds a comparative advantage.

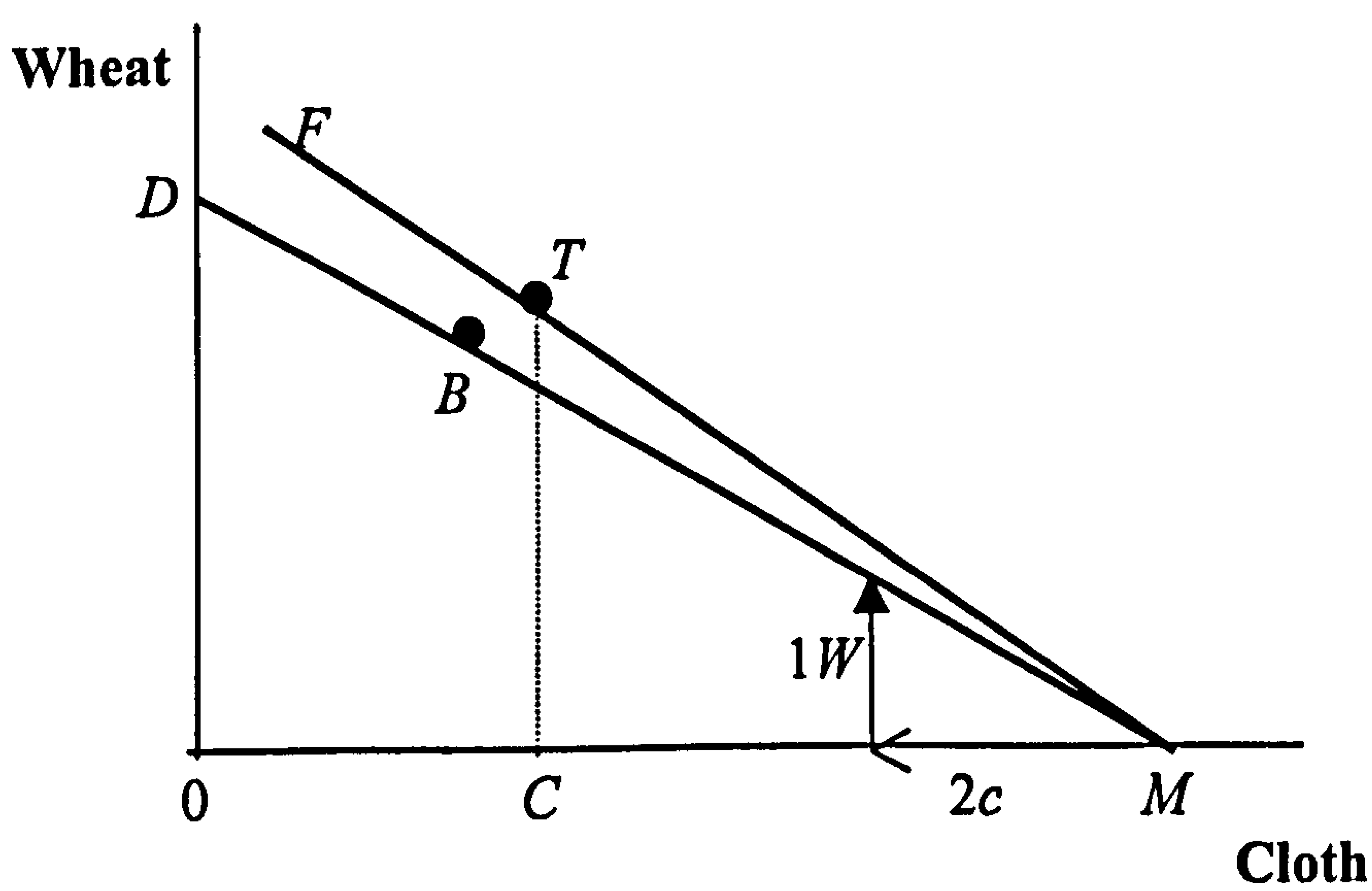


Figure 3.1: Pre-Trade and Post-Trade Positions for UK
Source: Meier (1980)

This is presented diagrammatically in (Figure 3.1), in which the production - possibility frontier for the UK is denoted by MD. The location of M and D is determined by the total supply of labour in UK. The points along MD indicate the various maximum possible combinations of wheat and cloth that could be produced in the UK with the existing labour supply. In the pre-trade situation, the domestic exchange ratio between the two commodities would be:

1.5 Wheat : 1 Cloth in the USA, and
1 Wheat : 2 Cloth in the UK

"The exchange ratio in physical units is the reciprocal of the price ratio" (Meier, 1980, p.20). Thus, wheat is comparatively cheap in the USA, whereas cloth is comparatively cheap in the UK.

In figure 3.2, the slope of MD shows the rate at which the resources embodied in the production of one commodity can be transformed into the production of another commodity. In this case the labour that produces 2C can be transformed into the production of 1W by sacrificing the production of 2C. The condition of constant costs in each activity makes MD a straight line. The slope of the production frontier is termed the (marginal rate of domestic transformation) (MRTd) because it shows the rate at which one commodity can be "transformed" into another in the production process.

The slope or MRTd can also be seen as identifying the marginal cost of one commodity in terms of the other or as denoting the opportunity cost of one commodity in terms of the other. If product markets are perfectly competitive, prices must equal marginal costs. Therefore, the slope of the production possibility curve also indicates the ratio of marginal costs of the two commodities. The marginal cost, or opportunity cost of producing one more unit of W, is the forgone production of 2 units of cloth.

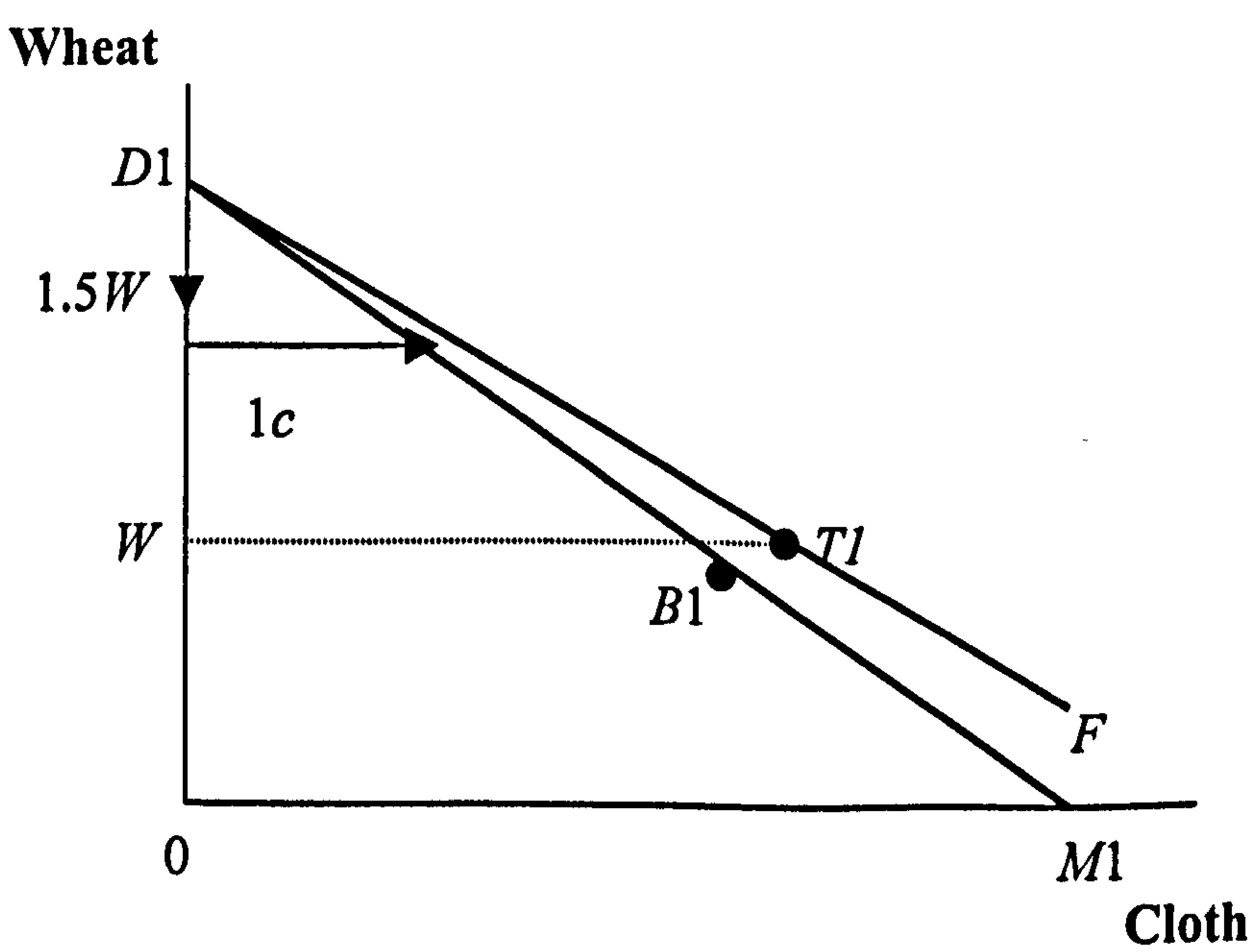


Figure 3.2: Pre-Trade and Post-Trade Positions for USA
Source: Meier (1980)

The USA has a different production choice, determined by its total supply of labour and ratio of marginal costs, such as that shown in figure 3.2. Given different production frontiers in the two countries, a basis for international trade arises from these relative productivity differentials or differences in the countries comparative cost ratio. After opening the UK and the USA to foreign trade, some exchange ratio on world markets will be established. This international exchange ratio must lie within the range of the domestic exchange ratios, between USA 1.5W: 1C ratio and UK 1W: 2C (ignoring transportation costs). Otherwise one country would not trade.

To show that both nations can gain, suppose the US could exchange 6 wheat for 6 cloth with the UK. The US would then gain 2 cloth (or save a half-hour of labour time) since the US could only exchange 6 units of wheat for 4 units of cloth domestically. At the same time, the UK would also gain, the 6 wheat that the UK receives from the USA would require six man-hours to produce in the UK. The UK could instead use these six man-hours to produce 12 clothes and give up only 6 cloth for 6 wheat from the US. Thus, the UK would gain 6 cloth or save three hours of labour time.

Once again the fact that the UK gains more from trade than the USA is not important at this point, what is important is that both nations can gain from trade even if one of them (in this case UK) is less efficient than the other in the production of both commodities.

To summarise, the USA gains to the extent that it can exchange 6 units of wheat for more than 4 units of cloth from the UK. The UK gains to the extent that it can give up less than 12 units of cloth for 6 units of wheat from the USA. Thus the range for mutually advantageous trade is:

$$4C < 6W < 12C$$

3.3.1 THE ASSUMPTIONS OF THE THEORY OF COMPARATIVE ADVANTAGE

Bö Sodersten (1985) in 'International Economics' clarifies the assumptions of the theory of comparative advantage by stating that the simple theory of comparative advantage is based on a number of important assumptions:

1. There are no transport costs. In reality, transport costs always exist and they will reduce and sometimes eliminate any comparative cost advantages. In general, the higher the proportion of transport costs in the final price to the consumer, the less likely it is that the goods will be traded internationally.

2. Costs are constant and there are no economies of scale. This assumption helps make the example easy to understand. However, the existence of economies of scale will tend to reinforce the benefits of international specialisation.

3. There are only two economics producing two goods. Again this assumption was made to simplify the explanation. But the theory of comparative advantage applied equally to a world with many economies producing a large number of traded goods.

4. The theory assumes that traded goods are homogeneous. Commodities such as steel, copper, or wheat are bought on price. But a Toyota car is different from a Rover car and so it is far more difficult to conclude that, for instance, the Japanese have a comparative advantage in the production of cars.

5. Factors of production are assumed to be perfectly mobile. If they were not, trade might lead to a lowering of living standard in a country.

6. There are no tariffs or other trade barriers.

7. There is perfect knowledge, so that all buyers and sellers know where the cheapest goods can be found internationally.

3.3.2 SOURCES OF COMPARATIVE ADVANTAGE

The immediate cause of international exchange of goods and services as Williamson and Milner (1991) argue is the existence (pre-trade) of intra-country differences in the price or quality of competing goods. There is a large number of demand and supply factors which may account for these intra-country differences.

Countries will tend to specialise in the products of specific industries, or of a certain product range or of a certain stage of production, and export those products, which in advance of trade have the lowest relative cost of production. Differences in relative cost between countries is a source of comparative advantage and therefore of trade.

Empirical studies (e.g. Hufbauer and Schott, 1996 and Meier, 1980) have demonstrated that the commodity composition of the exports of developed and developing countries is significantly correlated with a range of national attributes such as resource endowments and technological factors. Indeed, this evidence might be interpreted as supporting the view that actual international flows are "explained" by an amalgam of theories. Specific theories tend to concentrate, however, on a single source of dissimilarity or comparative advantage.

3.3.3 THE SCOPE FOR INTERNATIONAL SPECIALISATION

When the dynamic quality of comparative advantage is recognised together with the continually changing character of the international division of labour, the prospects for international trade can be considered.

Meier (1980) argues that the volume of trade will also depend on the structure of comparative costs. Moreover, he explains that the scope for international specialisation will be wider, and the trade potential greater, the wider the gaps in the comparative advantage of different countries. Furthermore, as national output grows, the composition of that output might be pro-trade biased, in the sense that exports increase in greater proportion than import - competing commodities, or national growth might be anti-trade biased, in the sense that import substitutes increase in greater proportion than exports.

There are strong forces that tend to widen the gap of comparative advantage and expand the scope for international specialisation and trade. Technological change, both rapid in pace and extensive in range, keeps production functions different in various countries. Technical advances in transportation and communication also promote specialisation.

Economies of scale in the production of exportables widen comparative advantage. As income rises, the income - elasticity of demand also tends to increase, and this creates a greater demand for more differentiated products - and hence more specialisation.

Finally, the most important development in recent years that has a significant effect of widening comparative advantage is the growth of the multinational corporations. This intensifies international specialisation by allowing a potential comparative advantage in an overseas country to become effective through the receipt of capital and technology. It is therefore not surprising that the forces that have accelerated the process of internationalisation and globalisation of markets should also be the forces that will increase the scope for international specialisation. This is the scope of the movement towards free trade, and the economic basis that helps to build the idea of World Trade Organisation (WTO), which promises the world welfare and that each country will be better of by trading and by open its market.

This chapter began by indicating the major determinants of the structure of international trade, it should end by considering the gains from trade and the welfare implications of trade, which are so essential for evaluating trade policy.

3.4 THE GAINS FROM TRADE

It was implied that there are gains from trade based on a rational pattern of international specialisation; it was also indicated what the trade structure would be under free trade, with the further implication that free trade should be pursued because the resulting specialisation and voluntary exchange can raise the real income of each trading nation. Trade offers each country the possibility of specialising in the line of its comparative advantage and then exchanging these products for those in which she has a disadvantage.

Ricardo suggested that the gains from trade could be measured in terms of the greater consumption available to a country for the same input of labour. To Ricardo the extension of foreign trade makes a powerful contribution to the increase in the mass of commodities, and therefore, the sum of enjoyments. And this will be true for each trading nation. This can be concluded as:

- Free trade is superior to no trade;
- Free trade is superior to a tariff.

According to Meier (1980), in each case the gains from trade are composed of a **consumption gain** and a **production gain**. Whether expressed as an increase in the "mass of commodities and sum of enjoyments", an increase in consumers' surplus or an increase in real income, the consumption gain amounts to the substitution of lower-cost imports for higher-cost domestic goods.

The production gain arises from the allocation of resources away from the direct production of importable in higher-cost home production to the specialisation in the lower-cost production of exportable. The export sector indirectly "produces" the importable on the world market, and this conversion of domestic resources into foreign resources will raise the trading country's real income if the alternative domestic employment of resources used in the export sector would have lower productivity. Moreover, the gains from trade are mutual gains: every trading nation enjoys a consumption gain and a production gain.

Anderton (1995) indicates that free trade is also optimal in the sense of representing a pareto-efficient situation in which no one can be made better off without someone else being made worse off. The virtue of free trade is not only that it makes world production efficient in the technical sense but it also leads to economic efficiency in the pareto-efficiency sense of achieving a situation in which it is impossible to make someone better off without making anyone worse off. This follows from the fact that, under free trade, consumers face the same prices in both countries. Again, both technical efficiency and exchange efficiency are achieved, producers are in equilibrium and consumers are in equilibrium.

3.4.1 DISTRIBUTION OF THE GAINS

According to the theory of comparative advantage, all the trading nations gain under free trade. But how are the gains divided among the nations?

Salvatore (1983) discusses this question and indicates that, this will depend on both the volume of trade and the terms of trade. The greater the volume of trade, the greater the gains from trade, on the average, for each country through international specialisation. The more favourable the terms of trade for a country, the more that country gains, it can export less for the same volume of imports, or it can import more for the same volume of exports. Therefore, its real income from a given output rises as its terms of trade improve. To Mikic (1998) a country's income terms of trade can improve at the same time as its commodity terms worsen.

John Stuart Mill, in his principles of political economy (1848), indicates that the dynamic aspects of trade are of equal importance to the gains from trade discussed above (Meier, 1980).

The dynamic gains from trade can be summarised as a movement along the production frontier in accordance with the pre-existing comparative cost situation, which then tends to push the production frontier upward and outward. Above and beyond the static gains that result from the more efficient resources allocation with given production functions, international trade also transforms production functions and induces outward shifts in the production frontier.

3.5 TOURISM AND THE INTERNATIONAL TRADE THEORY

International trade in tourism is now an important issue in international trade in services, and, in general, in international trade policy. However measuring countries' competitiveness in internationally tradable services is fraught with many conceptual and practical difficulties.

The last section explained that, one of the most well-known explanations of international trade is the Recardian theory of comparative advantage. The theory's distinctive contribution lies in its main tenet that even if one country is more efficient in absolute terms in producing goods than another, short run gains from trade can be obtained, if it specialises in the production and export of the goods which is produces relatively efficiently, i.e. in which it holds a comparative advantage. If each country were to specialise, total output would be greater as a larger quantity of the goods could be produced for given inputs. The theory, thus, predicts that the pattern of trade is determined by differences in the relative efficiencies of production in different countries and that gains can result from specialisation in production.

Sinclair and Stabler (1998) state that according to Recardian theory, given competitive conditions, each country's domestic (non-trade price) ratio is determined entirely by supply side conditions, the relative efficiency of production stemming from technology. In fact, the post-trade price ratio is determined by both supply side conditions and by demand, based on consumers' preferences for traded products.

Departing from the static context of the theory, differences in the rates of growth of demand for the two products can result in a movement in the commodity terms of trade (defined as the price of exports divided by the price of imports).

The Hecksher-Ohlin theorem posits that there are other factors of production along with labour, which determine the country's comparative advantage:

- Labour;
- Capital;

- Land (natural resources).

Thus countries such as Egypt and Tanzania, which have a large supply of labour and land as well as plentiful natural and man-made tourism resources would appear to have a comparative advantage in tourism. According to Hecksher-Ohlin, countries with an abundance of certain resources will benefit from a comparative advantage for the production and export of products requiring these resources. For example a country which is relatively well endowed with labour is said to have a comparative advantage in producing and exporting goods which are produced labour intensively, while a country which is capital abundant has an advantage in producing and exporting capital-intensive goods.

3.5.1 THE THEORY OF COMPARATIVE ADVANTAGE AND TOURISM

Bull (1998) argues that the principal of comparative advantage can be applied to the tourism sector. He states that it is possible to identify advantages, which serve to explain reasons for international tourism's existence:

- There may be specific base resources in certain countries, which are a fundamental tourist attraction, for example, the Grand Canyon or the lack District. Tourists from Britain may therefore exchange 'consumption' of the Lack District for 'consumption' of the Grand Canyon with tourists from the United States.

- Some countries offer an all-around advantage in the production of tourism services. Such as an attractive climate plus plenty of beach space and low labour coasts. Spain and Mexico are good examples; Romania and Bulgaria directly 'exchange' tourism for goods from more northerly Comecon countries.

- A destination country's geographic location relative to mass tourism generators may be such an important 'pull' factor that it pays that destination country to concentrate transferable resources into tourism, even from industries which are more efficient than they are in the generating countries. This is especially true of small, two-or-three-industry economies such as some Caribbean countries.

In addition to comparative advantages, Lundberg et al (1995) state that differing tastes, the constant desire of some types of tourist for new and foreign experiences, and changing international constraint conditions (such as variable exchange rates) combine to provide an economic rationale for international travel and tourism.

Tourism analyses have resulted in a reappraisal of international trade theory with respect to services. Tourists sometimes visit country because its product is entirely different from anything available domestically, rather than merely because of a price advantage. They therefore, make use of specific tourism resources or factor endowments possessed by the destination. This view is consistent with economic models of international tourism demand based on Heckcher-Ohlin theories.

The theory of comparative advantage suggests that countries specialise in the production and export of their most competitive goods and services. However, this specialisation is rarely exclusive. According to Sinclair and Stabler (1998), the analysis of international commercial exchanges only indicates a tendency towards specialisation in relation to comparative costs. This also happens in international tourism. Although there are wide fluctuations in costs, it is difficult to determine what a country specialises in by price alone. Nonetheless, comparative costs can be considered as one of the determining factors in the distribution and trends of international tourism.

The comparative cost model adapted from Ricardo explains bilateral exchange of tourism products as a result of differences in prices between two countries.

3.5.2 THE ROLE OF COMPARATIVE COSTS IN INTERNATIONAL TOURISM

Lundberg et al (1995) state that comparative advantage in economic terms means that there are differences in opportunity costs between various parts of the world, cities, regions, and nations. A place has a comparative advantage in producing a particular good and can produce that good at a lower opportunity cost than competitors.

Vellas and Becherel (1995) suggest that the importance of comparative costs in international tourism is increasing. There is a greater diversity in tourism products. Comparing such a diverse range of products is very difficult and often impossible. Furthermore, tourism products are generally services that cannot be repeated in an identical way every time. Therefore, the study of comparative costs must be orientated towards the specific attributes of international tourism. It cannot merely analyse the components of cost (transport, accommodation, and associated services). It must also take into account the quality-price ratio and technological advances.

3.5.2.1 The Quality-Price Ratio

The concept of quality implies more than just price. Switzerland and Germany, for example, are amongst the world's leading tourism countries and yet their tourism prices are relatively high. This suggests that service quality is one way to compete and to have a comparative advantage. A country can compete internationally by improving the quality-price ratio of its products. It generally adopts a policy of using quality as a way of differentiating its tourism sector from that of its competitors.

3.5.2.2 The Cost of Transport

Trends in transport costs affect the cost of tourism products. Transport costs depend on different elements, notably technology (adopting means of transport to the needs of the international tourism), the structure of transport companies, the cost of fuel and government policy. In particular, specific policies aim at lowering the cost of transport for international tourism.

3.5.2.3 Accommodation Costs

Accommodation costs directly influence tourism movements, especially in periods of economic crisis and high energy costs, the tourism cost often "compensates" by putting constraints on the price of accommodation so that the package is within the purchasing power of the tourist (in other words adapting to demand). Accommodation costs are influenced by several factors:

- The use of new technology in construction, equipment and fittings. For example, certain new two star hotel chains, using new building techniques and installing innovative receptions and customer services, have succeeded in reducing accommodation costs.

- Labour costs and productivity are important when comparing international accommodation costs. By using new techniques, certain developed countries are experiencing a "return to comparative advantage" despite high labour costs, and can compare again with countries with low labour costs. This phenomenon, already observed in the textile industry, can be explained by the rapid progress of technology.

3.5.2.4 The Cost of Tourism Services

The cost of tourism services, excluding transport and accommodation, are those relating to hospitality, catering and various leisure services. These costs are difficult to compare from country to country because tourism supply is extremely diverse. Nonetheless, they should be taken into account when analysing the distribution and the development of international tourism flows.

3.5.3 FOREIGN EXCHANGE POLICIES, COMPARATIVE COSTS AND INTERNATIONAL TOURISM

The comparative costs of tourism products from country to country are subject to exchange rates and at times, this greatly influences international tourism flows greatly.

According to Vellas and Becherel (1995), variations in exchange rates have a decisive effect on comparative cost trends of international tourism and therefore on tourism flows and distribution. For instance, those countries around the Mediterranean, use foreign exchange policy as the basis for their international tourism policy (for example, the devaluation of the peseta in 1992 resulted in a rise in arrivals to Spain). It allows these countries to sustain and even improve competitive tourism prices despite often high inflation rates. They are anxious to maintain comparative cost advantages at the expense of exchange rate fluctuations by, for example, devaluing the currency. Along with a number of other factors (such as variations in the GNP and the balance of payments), fluctuations in exchange rates are largely responsible for the diverging trends in tourism expenditure by the main OECD countries.

Although international tourism can be sensitive to exchange-rate fluctuations, this is often mitigated by consumer habit. Price fluctuation will primarily influence the length of stay rather than the number of arrivals.

3.6 THE THEORY OF FACTOR ENDOWMENT AND INTERNATIONAL TOURISM

The theory of factor endowment defines the basis of international tourism flows between countries. "Indeed, international exchanges, be they commercial flows or tourism flows, can be defined as the difference in the proportion of factors of production of each product exchanged" (Vellas and Becherel, 1995, p.73). A country will tend to specialise in the production and sale of goods and services, which it has in abundance and are consequently cheap. On the other hand, it will tend to purchase goods and services, which are unavailable in the country. In international tourism flows, goods exchanged are tourism services.

Countries, which have an abundance of tourism resources, will tend to develop an international specialisation in the tourism sector. Thus a greater likelihood that they will export their international tourism services which results in a positive balance in the travel account. This situation is found in many of the Mediterranean countries (for example, Spain with the Balearics and the Canaries, Greece and its island, Egypt and its history, Turkey, Tunisia and Morocco) which have an abundance of tourism resources such as beaches, sea, sun and many resorts.

However, international tourism specialisation does not just imply that tourism countries are solely receptors, they can also be tourist generators. As a general rule, the higher their GNP, the more likely they are to be tourist-generator countries. Amongst the Mediterranean countries, France and Italy are both generators and receptors of tourists. This interchange of tourism products corresponds to the demand for difference, which exists for manufactured products from different countries.

Thus, to apply the factor endowment model to tourism, new hypotheses already present in neo-factor analyses of international commerce must be integrated into the model. These hypotheses include natural resources and the increase in the number of factors of production.

Sinclair and Stabler (1998) state that the HO theory is useful in so far as it points to the role which the supply-side can play in determining the pattern of international production and trade. It might, at first sight, be assumed that tourism provision is labour intensive, as is the case for the accommodation sector, so that countries, which are well endowed with labour, have a comparative advantage in tourism.

However, on the other hand, tourism can involve large inputs of capital as well as skilled labour, as in the case of Turkey, which is supposedly a labour-abundant country. Like Egypt, which now has large inputs of capital, especially at the new tourism areas, which have developed recently, such as (Hurgada, Sherm-El-Shekh, and Taba).

Therefore in some cases we can consider tourism as a labour intensive, and in other cases we can consider tourism as capital intensive, and this often occurs within a single destination. This makes it more complicated and makes its comparative advantage more difficult to measure.

The capital intensity of tourism varies between countries and can also vary over time, at different stages of tourism growth. Since tourism is not homogeneous it is likely that tourism is relatively labour-intensive in countries with large supply of labour and capital-intensive in countries which are capital-abundant.

According to Cooper et al (1998), the relationship between tourism production and factor endowment is further complicated by the problem of measuring factor abundance and quality. Abundance can be measured in terms of either quantity, and hence supply alone, or value, in which case demand also enters into play as higher demand for the product results in a higher price and higher value. Its quality is more difficult to ascertain as, for instance, labour can be classified as skilled or unskilled and capital can be of differing vintages and efficiency.

When the third factor, land, is considered, the situation becomes even more complicated. Land in the form of natural resources or the built environment is an important element of the tourism product. In fact, tourism is an industry based upon real estate. It is not clear whether land is complementary to capital or labour or both. Land may be complementary to capital in some types of tourism supply. For example, some tourism products within an economy, which is well endowed with labour, may be capital-intensive. Game tourism for high-income groups visiting Kenya, where light aircraft are used to gain access to more remote areas, is an example.

Alternatively, according to Sinclair and Stabler (1998), land may be complementary to labour, as in the case of trekking holidays in Nepal. The issue of whether a capital-intensive form of tourism production can become more labour-intensive in an economy characterised by under- or unemployed labour or, conversely, whether tourism can become more capital-intensive in a context of low birth rates, is clearly important. In Spain, for example, traditionally labour-intensive hotels have introduced self-service in restaurants as wages have risen, despite the context of high national unemployment rates. Changes in the factor intensity of production and comparative advantage can be advantageous or disadvantageous to a country and require consideration in a dynamic rather than static context.

3.6.1 THE IMPORTANCE OF NATURAL RESOURCES

Natural resources are the most important tourism factor and are unique to each country. They cannot be moved and are a major motivation for tourism. The importance of natural resources, already commented on by Buchanan, Brown and Leontief, completes the factor endowment model and adds to its significance. However, from an empirical point of view, international comparisons between the natural endowments of different countries are particularly difficult. Indeed, natural resources are heterogeneous and therefore almost impossible to evaluate, but, nonetheless, they play a decisive role in international tourism specialisation.

3.6.2 THE ROLE OF JOB SKILLS

To examine the quality of the factors of production, capital and labour must be broken down into several distinct sub-factors. The labour factor is subdivided according to skill. The comparative advantage of countries depends on the amount of available skilled and unskilled labour. This distinction plays a crucial role in international tourism, which relies largely on manpower.

3.6.3 LIMITATIONS OF INTERNATIONAL TOURISM FACTOR ENDOWMENTS

The factor endowment model advances an accurate explanation of international tourism flows. However, it does have certain limitations, which cannot take into account:

- Demand based on the search for "something different" which can be a result simply of the existence of international borders;
- Availability;
- Absolute non-availability.

3.6.3.1 Differentiation

It is possible to demonstrate that the mere existence of international borders can stimulate demand based on the need for 'something different'. This explains certain types of international economic relations. In international tourism, it constitutes an important modifier to factor endowments. In this case, it is not the conditions of supply, which explain the causes of international tourism but the condition of demand. Bull (1998) argues that tourists are motivated to cross borders because they want to experience something different, a need they can not satisfy in their own countries. The need for a change accounts for reciprocal international tourism exchanges between neighbouring countries, despite the possession of similar resources.

3.6.3.2 Availability or Non-Availability

Kravis, continuing the debate begun by Adam Smith, demonstrated that a certain number of international exchanges can be explained by absolute availability and non-availability. This can also be applied to international tourism. Tourism sites classified as 'unique' create flows that are not in direct competition with, for instance, seaside or climatic resorts. Similarly, the absence of a coast for landlocked countries such as Austria and Switzerland is an important factor for international demand for tourism products on the coast for other countries.

Thus, to consume the tourism product they desire, tourists may have to travel to other countries. Belgian and Dutch demand for ski holidays can only be satisfied in countries which have skiing facilities. Japanese or German tourists who want beach holidays in winter must also travel abroad. In these cases, non-availability modifies potential tourism demand and international tourism demand because of the fact that it is impossible to satisfy the demand within their own country.

Consequently, it is not the relative resources that are the basis of international exchanges but the absolute resources.

To summarise, Ricardian theory is useful in indicating the gains which countries can make from international tourism if they are relatively efficient in tourism production and, hence, points to the importance of increasing production efficiency.

The HO theorem on the other hand, emphasises the role of countries' different resource endowments and also helps to explain international trade and tourism. Sinclair and Stabler (1998) indicate that an obvious implication of the HO theorem is that further research should be under taken to investigate inter-country differences in the factors of production which are used in tourism and the ways in which countries might used their resources more effectively. However, the theorem's assumption that land, labour and capital are homogeneous can be called into question and relative factor endowments can change over time. For example, consideration of the differences between the natural and built environment resources used in tourism in different locations demonstrate the significant inter-country diversity of the supply of land and natural resources.

The theories of comparative advantage concentrate on supply-side differences in relative factor efficiency and factor endowment, and neither Ricardian theory nor the HO theorem pays sufficient attention to the role of demand; for example, diversity of demand may occur as preferences relating to the consumption of tourism and other goods differ between countries.

Moreover, Lundberg et al (1995) explain that the assumption of competitive market condition, while offering interesting insights into the determination of comparative advantage in tourism, precludes examination of features, which characterise imperfectly competitive markets. Thus, the theories of comparative advantage neglect such characteristics as increasing returns to scale, market power and control over pricing or output, product differentiation, transport costs, inter-country differences in demand, market segmentation, differences in factor 'quality' and differences in countries' access to information and technology. A number of these considerations are relevant to an explanation of the high level of international tourism flows occurring between countries with similar factor endowments and similar levels of income and wealth.

3.7 INTERNATIONAL TRADE POLICY

The theory of comparative advantage shows that trade between countries will be mutually beneficial if relative costs of production differ, so the theory developed by David Ricardo suggests that free trade is the optimal trade policy because it maximises a country's welfare. In autarchy, countries can only consume on their production possibility frontier. With trade, a country is better off because it can extend its consumption possibilities through specialisation. Specialisation enables total world production to be very much higher than if there were no international trade (Anderton, 1995).

Despite the mutual gains from international trade, the countries of the world often interfere with the operation of free international markets. Governments have always attempted to control trade to at least some extent. Meier (1980) states that there were many, who argued and some who still argue that a nation's wealth consists of the amount of gold or other money at its command. According to this view, the proper aim of government policy was to promote exports and discourage imports, for that would increase the amount foreigners owed the nation.

Baumol and Blinder (1991) argue that there are obviously limits to which this policy can be pursued. A country must import vital foodstuff, or critical raw materials that it cannot supply for itself; for if it does not, it must suffer a severe fall in living standards as well as deterioration in its military strength. Moreover, Kenen (1989) illustrates that it is mathematically impossible for every country to sell more than it buys. One country's exports must be some other country's imports then obviously exports must go the same way. The result will be that every one is deprived of the mutual gains that trade can provide. Trade restrictions usually turn out to be inefficient instruments. Nevertheless, governments continue to use them, and many new trade barriers have been erected recently.

This section will discuss questions of trade policy starting with a brief history of tariff policy, leading to the years of trade liberalisation after World War II.

3.8 HISTORY OF PROTECTIONISM

The term protectionism may be defined in a number of different ways. Aggarwal and Bisawas (1989, p.132) defined it as "the adoption or retention of trade restrictions for the purpose of protecting the economic well-being of particular groups of individuals or business organisations within a nation".

Protectionism has a natural and often vocal political constituency among those who see their livelihood threatened by foreign competition, whereas free trade is supported primarily as an ideal by those who are cognisant of its generalised, long term advantages.

The most popular method of protectionism used long ago is tariff. In the USA, during the first half of the nineteenth century, the infant industry argument was very popular. The country had just started its industrial development, and its new manufacturers sought protection from foreign competition. Tariffs rose sharply during the first three decades of the nineteenth century, fell for the next three, but rose rather steadily from the start of the civil war until the eve of World War I.

In the UK, many arguments for tariffs were used for the opposite purpose, the US was moving toward protection; the UK was moving toward free trade. France and Germany participated briefly in the movement toward free trade, which spread from Britain by way of trade treaties containing the most favoured nation clause. But they raised their tariffs during the last quarter of the century, when French and German farmers encountered import competition and joined factory owners in demanding protection (Kenen, 1989).

After World War I, tariffs rose sharply, reached their peak in 1930. In addition, many countries started to use quotas and other controls to protect their economic against the spread of the depression.

Trade liberalisation began again, however, when the Roosevelt administrations started the trade Agreements program. It was interrupted by World War II, but resumed in 1947 with the signing of the GATT and the first rounds of GATT negotiations.

During the 1950s, protectionism pressures in the US slowed down trade liberalisation, but it regained momentum with the formation of the European Economic Community (1956), the passage of the trade expansion act, and the GATT Kennedy round of tariff cuts (Schuknecht, 1992).

According to the GATT (1980), trade liberalisation took a new tack in the 1970s. In the Tokyo Round (1976), governments attempted to reduce non tariff barriers along with tariffs, and agreed on codes of conduct dealing with purchases by governments themselves and with subsidies and dumping.

But protectionism pressures built up in the 1960s and became more intense in the 1970s, slowing down the volume of trade for the first time since the Second World War. Following the OECD report about protectionism (1998), one factor, which has contributed to this slow down, has been the growth of protectionism. The 1970s and 1980s have witnessed a significant increase in the level and extent of protectionism in the world trading system. This has mainly taken the form of non-tariff interventions by governments, tariff levels have gradually been reduced over the course of seven rounds of multilateral tariff negotiations conducted through GATT. Much of the protectionism of this period has been aimed against imports coming from Japan and the newly-industrialising countries of South East Asia, Latin America and the South of Europe.

At one time, the US was severely criticised for following practices of protectionism. Today, the EC comes in for most of the criticism, because of its common agricultural policy. The less-developed countries, were promised preferential treatment, which turned out to be small, and were promised special treatment in the Tokyo Round, but did not get much. All these issues came up again in the Uruguay Round, which attempted to liberalise trade in both goods and services.

3.9 METHODS OF PROTECTIONISM

It seems paradoxical that today most nations impose many restrictions on the free flow of international trade. According to Salvatore (1983), trade restrictions are advocated by the few industries and their workers who are hurt by imports. As such, trade restrictions benefit the few at the expense of the many, who will have to pay higher prices for competing domestic goods.

There are many ways in which a country may choose to erect trade barriers. They differ, not only in form and manner of application, but also in the nature and severity of their effects upon trade.

3.9.1 TARIFFS

"A tariff is an indirect tax on an imported good" (Mikic, 1998, p. 279). In this respect, a tariff is an amount of money paid by an importer to the government to allow them to bring goods into the country. The term tariff may also be applied to the entire schedule of such duties listed on a product-by-product basis. This tax creates a wedge between the world and domestic prices of goods. It is sometimes called an import duty or a customs duty.

According to Winters (1985), tariffs may be levied in two different ways: a specific tariff is levied as a fixed amount of money per unit quantity of imports, an advalorem tariff, on the other hand, is levied in percentage per unit value or per unit price of the imported good.

Tariffs are generally levied for one of two purposes, either to provide revenue for the government of the tariff levying country or to protect industries in that country from foreign competition. Many developing countries rely heavily up on tariffs for revenue purpose, partly because importing and exporting often comprise a large component of overall economic activity, but also because their governments find import and export duties easier to collect than other types of taxes. Imports in such countries are often quite price inelastic so the government knows it will raise the revenue.

3.9.2 QUANTITATIVE RESTRICTION (NON-TARIFF BARRIERS)

Tariffs are the oldest and best-known method by which national governments attempt to regulate international trade. However during the past-century in particular, governments have devised and utilised numerous other methods. These non-tariff barriers have taken on increasing significance within the regulatory framework, partly as a consequence of multilateral negotiations and agreements that have reduced the power and prominence of tariffs.

Non-tariff barriers are non-tax measures imposed by a domestic government to discriminate against foreign producers and in favour of domestic ones. While tariffs generate revenues, non-tariff barriers can be seen as generating additional costs (Williamson and Milner, 1991).

Non-tariff barriers include any government policy or practice that has a direct effect upon international trade. These effects often are more thought of in terms of impeding imports, but the category also takes in subsidies or other measures that governments may use to promote exports from their country. One of the major types of non-tariff barriers is the quota, which is a quantitative limit on imports or exports (Weekly and Aggarwal 1987).

3.9.2.1 Quota

1. Import Quotas

Williamson and Milner (1991) argue that import quotas are the most known quantitative method of restricting trade. It specifies the maximum amount of a product, which can legally be brought into a country during a given time period. This amount is usually expressed in physical units, but often represents some percentage share of the market for the product in the country that is imposing the quota. Moreover, Weekly and Aggarwal (1987) state that a quota is usually accompanied by a licensing system, which controls the allocation of quotas among importers.

2. Export Quotas

Governments also use quantitative limits to restrain exports. These export quotas may be imposed for many reasons. One purpose is to prevent military goods or other strategic products. Export quotas are also employed in connection with international commodity agreements. These agreements are designed to stabilise the prices of food stuffs and raw materials, and such stabilisation efforts often entail limitations upon the amounts of the commodity that each producing country can export during a given time period. The basic aims of these export quotas are to regulate the total supply of the commodity that is being offered for sale in the world market, so as to prevent sharp price fluctuations and to keep the average price level higher than it would be in the absence of supply controls.

In addition, Mikic (1998) states that another purpose for which export quotas are imposed is to preserve the available supply of some product or commodity for domestic use. Scarcity of a good resulting from production short falls or sudden increases in demand may induce governments to set limits on exports to help ensure that domestic needs will have priority over sales to foreign countries.

3.9.2.2 Other Non Tariff Barriers

There are other non-tariff barriers imposed by government to control international trade. Baumal and Blinder (1991) suggest that the number of these regulations have been extremely difficult to identify and even harder to measure the extent of their influence on trade flows. A good example of this restriction is export subsidies, which refer to a payment by the government to an exporter. Subsidies reduce the exporter's costs and permit them to lower their selling prices and to compete more effectively in world trade. Many governments use subsidies to assist their industries, which creates unfair competition in international trade.

3.10 ECONOMIC EFFECTS OF TARIFFS

3.10.1 PARTIAL ASPECTS

The effect of a tariff is to raise the price of the good on which duty is levied. Ethier (1988) states that when a national government levies a tariff on a particular imported product, the intent is to make that product more expensive for domestic buyers to purchase. The corollary intent is, of course, to induce those buyers to shift their purchases to domestically produced goods as substitutes for the imported product.

Such a shift in demand is expected to benefit domestic producers by enabling them to increase the quantity of their output and sales, or the prices they charge or both.

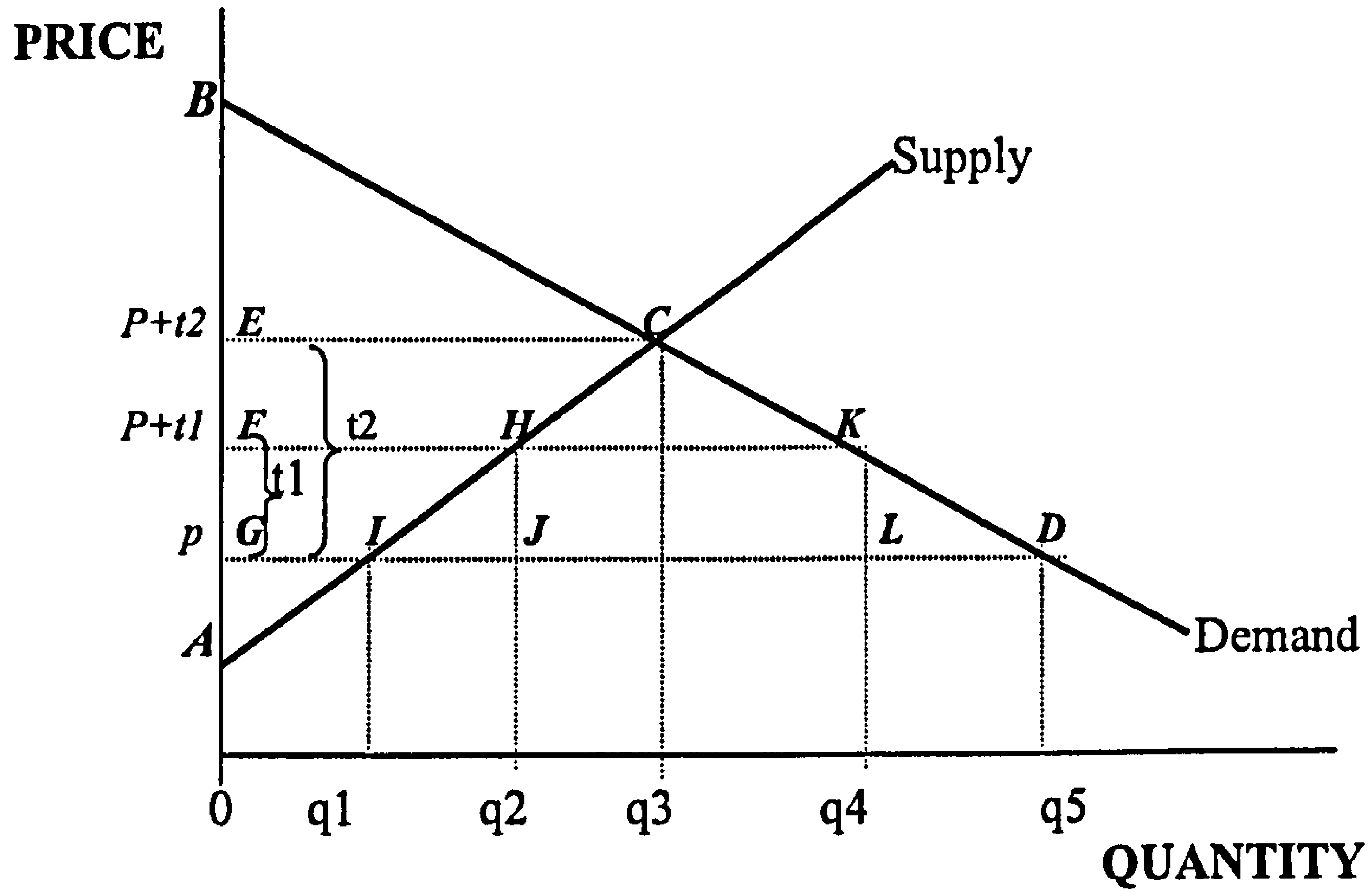


Figure 3.3: Effects of Tariff: The Partial Aspect

Source: Bö Sodersten (1985)

Bö Sodersten (1985) explains the effects of tariffs (see figure 3.3) and states that before the tariff, the price is *p* and *0q5* of the goods is consumed; of this amount *0q1* is produced within the country *q1 q5* is imported, then the tariff *t1* is levied on the good. This raises the price to *p+t1*; consumption falls to *0q4*, as the price of the good in the domestic market has increased. Domestic production at the same time increases with *q1 q2* to *0q3* and imports fall to *q2 q4*.

If a higher tariff, *t2*, were levied on the good, the price would increase even further, to *p+t2*. Domestic production would then increase to *0q3*. Hence consumption would equal domestic production and imports would fall to Zero. The tariff *t2* is an example of a prohibitive tariff "a tariff high enough to curtail all imports of the good".

From this example, it is clear that a tariff affects prices, consumption, production and imports. According to Winters (1985), a tariff is worse than free trade as it involves a cost for society or as it is often called, the cost of protectionism.

To illustrate this cost, in figure 3.3, tariff *t1* increased the domestic price of the good, this increase caused a loss in consumer surplus of *FKDG*. This is a loss, which the consumers of the good have to bear. Part of this loss in consumers' surplus goes to the government in the form of tariff revenue. This part in the figure equals *JHKL*. Another part of the loss in consumer surplus goes to producers in the form of an increase in producers' surplus. This part is *GIHF*. This leaves the two triangles *IJH* and *KLD* unaccounted for, and together these two measures the cost of production for the society as a whole.

The first of these two triangles, *IJH*, measures the production cost of the protection. If the country had imported the amount *q1 q2 HI*, the difference *IJH* represents a misallocation of resources brought about by the tariff. The economic reason for this is that if the country had used resources to a value of *q1 q2 JI* in its export industry, it would have produced enough exports to buy *q1 q2* of the imported good. When it instead produces it at home in a protected industry, it has to devote a larger amount of resources, *q1 q2 HI*, to produce *q1 q2* of the imported good.

The second of the two triangles, *KLD*, measures the consumption cost of the protection. The tariff introduces distortion in consumption. Because of the tariff, the value to the international producer of a unit of the good will be lower than the value to the domestic consumer. For the consumer, the tariff on the good will raise the price in comparison with other goods, giving rise to a distortion of consumption for the consumers. The size of this consumption cost of protection is measured by the triangle *KLD*.

It was assumed in the preceding analysis that the price of the good increased by the whole amount of the tariff, while is the same as assuming that the terms of trade are not affected by the tariff. This is an example of the partial aspect of the analysis.

According to Weekly and Aggarwal (1987), this is hardly a realistic assumption. There is always the possibility absorbed by either the importer or the foreign producer(s) of the product, rather than being passed along to other buyers in the distribution chain. This means that the terms of trade of the country levying the tariff will improve, implying that the price of the good in the domestic market will increase by less than the full amount of the tariff.

According to Bö Sodersten (1985), there are no hard and fast rules for determining when or if an import duty will be absorbed. However, it is reasonable to expect that producers would be more likely to absorb some or all of such tariff if they felt that the demand for their product in the tariff-levying country was elastic. That is, if they think that buyers would act strongly to an increase in the price of the product via a more than proportional reduction in the amount that they were willing to purchase. The producers' inclination to absorb the tariff would also depend on how such an action would affect their profit margins, as well as on their perceptions regarding the importance of the market in the tariff-levying country and the availability of alternative markets for their output. Since these supply and demand factors vary greatly from one situation to the next, it is impossible to make any valid general prediction as to whether or to what extent import duties will raise the prices of the products on which they are levied.

Williamson (1991) states that a second element of uncertainty affecting the economic effects of import tariffs relates to how consumers in the tariff-levying country will respond to tariff induced increases in the prices of imported goods. The actual elasticity of demand will further determine the extent to which any price increase, resulting from a duty will decrease sales of the product involved.

Salvatore (1983) argues that this analysis means that the terms of trade of the country levying the tariff will improve, implying that the price of the good in the domestic market will increase by less than the full amount of the tariff. An improvement in a country's terms of trade implies an improvement in the country's real income, this gain from a tariff cannot be so large as to outweigh the cost of protection.

To sum up, the price of the good on which a tariff is levied will be raised in the domestic market, imports will fall and the domestic production of the good will increase. The government will receive an increased income in the form of tariff revenue. The national income of the country, however, will fall in the normal case because of the greater inefficiency in production and the distortion of consumption, which the tariff entails.

Bö Sodersten (1985) argues that tariff policy has in most countries been a widely discussed political issue, because the tariff has been felt to have a very direct impact on the wellbeing of citizens. If a tariff can save the livelihood of some citizens, it is understandable that they are interested in the existence or removal of that tariff.

3.10.2 TARIFF AND INCOME DISTRIBUTION: THE STOLPER-SAMUELSON THEOREM

The Stolper-Samuelson theorem demonstrates that the effects of a tariff are unambiguous within the context of the standard trade model. Following the Heckscher-Ohlin reasoning, a country exports the good, which is produced primarily with the help of its abundant factors of production. A tariff will decrease production of exportables and lead to an increase in production, the import-competing good, and benefit the scarce factor-that used intensively in the import sector. Thus a tariff will benefit a country's scarce factor of production in an unambiguous fashion and cause the real income of the abundant factor to fall.

In practice, the theorem can therefore also be said to provide valuable insight into the effects of a tariff on income distribution. It is no longer possible to believe simply that free trade will benefit all groups in society. On the contrary, the presumption is that a tariff will benefit one of the factors of production at the expense of the other.

Thus the general result of economic theory is that a tariff lowers the national income but benefits the country's scarce factor of production.

The thinking behind this is that export augments the derived demand for the abundant factor and imports relieve the relative scarcity of the other factor. Given this theorem, import protection in a labour-abundant, developing country benefits capital at the expense of labour, while the result is reversed in the case of a capital-rich, industrialised country. It is thus not surprising that labour in import-substitute sectors in capital-rich industrialised countries often opposes the removal of protection.

In practice, it is often difficult to predict how tariffs will affect the distribution of income between factors. Even where the effects are predictable, it is certainly not the case that they will necessarily be desirable. If, for, example, tariff in a developing country redistribute income towards capital, this typically benefits the higher-income and wealth-owing classes. Tariffs also tend to redistribute away from consumers of the tariff-protected consumer goods and towards the government (in the form of increased tax revenue) and producers (in the form of increased producer surplus).

But the gross loss experienced by consumers resulting from the increased price of importables is the decline in consumer surplus. The difference between these net and gross consumer losses is accounted for by the redistribution identified above. The equity or otherwise of this redistribution is impossible to establish on *a priori* grounds. It will depend on the nature of the protected good and the consumption basket of different income groups.

3.10.3 TARIFFS, TERMS OF TRADE AND DOMESTIC PRICE

Tariffs increase the domestic price of a good by the whole amount of the tariff, and it was later stated that this was hardly a realistic assumption. It is true that the immediate effect of a tariff is to increase the price of a good, but at the same time it will affect not only the consumption and production of the good itself, but also production and consumption of other goods, thereby affecting all relative prices.

Bö Sodersten (1985) states that the standard result from analyses of the effects of a tariff on prices in a general equilibrium setting are, a decrease in the volume of trade, and an improvement in the terms of trade for the country levied tariffs.

Hence the terms of trade will improve for the tariff-imposing country except in the limiting case in which the foreign country has a completely elastic offer curve, when the terms of trade are not affected by the tariff. In general it can be said that the larger the price elasticity of demand and supply in the foreign country, the smaller the change in the terms of trade. Large values on any elasticity imply that either consumer or producers (or both, if the two elasticities are large) are sensitive to changes in relative prices. If the demand elasticity is large, it means that consumers are easily able to substitute exportables for importables in consumption; if the supply elasticity is large, it means that producers can move factors of production easily from one sector to the other. In other words, the larger the adaptability in a country's economy, the smaller the chances are that it will suffer deteriorating terms of trade because of tariff increases in other countries.

The result of this so far is that tariff improves the terms of trade for the country, but this is not large enough to offset the tariff. Hence the domestic price of the import good will increase. This implies that the Stolper - Samuelson result holds good, and that the tariff will benefit the factor of production used intensively in the import-competing sector.

These results are the standard of the Stopler-Samuelson theorem, the opposite effects of the tariff is if the price of the imported good falls in the domestic market because of the tariff, then the relative price of exports will rise.

This means that production of exports will be more profitable because of the tariff, and resources will be transferred from the import-competing sector to the export sector. The factor reward of the factor used intensively in the export sector will increase and the income distribution will turn in favour of the country's abundant factor of production, i.e. the one used intensively in the export sector.

This is the result set up by Lloyd A. Metler. The economics behind Metler's result is, the larger a country's marginal propensity to consume exports, the larger the amount of its tariff revenue spent on demanding the good exported by the country. Hence an excess demand for exports may come from this source.

If the foreign country's demand elasticity for the first country's exports is low, it means that its demand for this good will fall only slightly, though its relative price increases. Under such circumstances, a tariff could create excessive demand in the tariff-imposing country's market for its export good. If this happens, the price of imports will fall because of the tariff.

3.10.4 TARIFFS AND THE NATIONAL INCOME: THE OPTIMUM TARIFF

As explained earlier, the effect of a tariff is to improve a country's terms of trade and to restrict trade by decreasing the volume of imports and exports.

At the same time the negative effect of the tariff is the misallocation of resources in production and in the distortion of consumption.

There is then a cost involved in protection. It might, however, be that the positive effect on the terms of trade is the larger; then there is a gain in production. If a country is in a situation of free trade, it can always improve its welfare by applying the "right" tariff. This tariff, "the tariff that maximises a country's welfare", is called the optimum tariff (Bö Sodersten, 1985, p. 180).

Krueger (1998) states that, the optimum tariff only potentially maximises a country's welfare. The optimum tariff will, like any tariff, affect income distribution. It will make some better off but make others worse off.

To increase a country's welfare in an unambiguous sense, therefore, the optimum tariff has to be accompanied by a redistribution policy to compensate those who are hurt by the tariff. As the optimum tariff, by definition, increases a country's total welfare, this will be possible and there will still be something left over for those who directly benefit from the tariff. It is in this sense that the optimum tariff is a proposition in welfare economies.

The optimum tariff also has a negative effect on the other country, the economic explanation, as Williamson (1991) illustrated, is that the export country will both suffer deteriorating terms of trade and a decrease in its volume of foreign trade.

Anderson (1998) argues that the only case in which the country levying the tariff will not benefit is when the other country offer curve is a straight line. The economic explanation is that its price elasticity of supply for exports is infinitely large. This means that the country without any cost or difficulty can shift factors of production from the export to the import-competing sector of production, and vice versa.

Leaving this special case, Bö Sodersten (1985) states that a single country can always improve its welfare by changing from free trade to a situation of optimum tariff, yet the restriction of trade that the optimum tariff implies will always hurt the second country.

To summarise, the higher the country's share of foreign trade, the larger the scope for its optimum tariff, explained by the fact that the larger the share of national income which the country exports, the more effective will a given improvement in a country's terms of trade be. Otherwise, the important factors stem from the second country (the rest of the world). Of the greatest importance are the effects produced by a change in relative prices on quantities consumed and supplied. The larger they are, the lower country I (The country that levying tariff) should set its optimum tariff. A tariff in country I will turn the terms of trade against country II. If the second country's price elasticity of supply is high, the country has a flexible structure of production. Producers can easily switch their factors of production from one line of production to another. If this is the case, then the terms of trade will not change much because of the tariff and the first country (levying the tariff) will not stand to gain much by levying one.

If the value of the supply elasticity is very large, there will be no change at all in relative prices because of a tariff, and country I's best policy will be one of free trade. A high value of country II's elasticity of demand for exports (or imports) with respect to a change in relative prices will play much the same role. It means that the goods are good substitutes and that consumers will easily adapt their habits of consumption to a change in relative prices.

Thinking in terms of developed and less developed countries, UNCTAD (1998l) observes that industrial, developed countries usually have a high degree of flexibility in their economies as far as both supply and demand are concerned. Less developed countries often show a low degree of adaptability in their economies, this means that less developed countries usually cannot expect to gain much from high tariffs and that their optimum tariffs are probably quite low.

The developed countries might, from this point of view, have more to gain from exploiting a monopoly position by applying high tariffs. So the optimum tariff for these countries is quite high at times; this applies especially to their trade with less developed countries.

3.10.5 OTHER EFFECTS OF TARIFFS

If a country has unemployment, a tariff can be used to produce an expansionary effect on the national income, Tharakan (1995). A tariff means that imports will decrease and that the demand for home-produced goods will increase. Hindley (1988) argues that, tariffs can be seen as a device switching demand away from international to home goods.

The use of a tariff for eradicating unemployment is example of what is sometimes called a 'beggar-my-neighbour' policy. If there is unemployment in both trading countries, the country levying the tariff will export part of its unemployment to its trading partner, producing a negative effect on its national income and an increase in its rate of unemployment. It is therefore very likely that it will retaliate and in turn increase its tariff. Trade warfare could break out and the likely result be that no one will benefit from the gradual increase in tariffs.

A tariff will usually also have a positive effect on a country's balance of trade. Willamson and Milner (1991) states that the initial effect of an increase in tariffs is to cut imports but to leave exports unchanged, thus improving the balance of trade. At the same time, the national income will expand, negatively affecting the balance of trade.

If repercussions are small and no retaliations occur, the trade balance may improve; but if imports in the tariff - increasing country go up significantly because of the increase in income caused by the tariff, and if foreign repercussions are great, then the temporary improvement in the balance of trade may quickly disappear.

A more efficient way of improving country's balance of trade is the appropriate use of monetary and fiscal policy, or devaluation.

3.11 INTERNATIONAL TOURISM AND TRADE BARRIERS

Tourism barriers are closer in kind to non-tariff barriers affecting trade in goods. As with such NTBs, their precise quantitative impact is very difficult to determine. Government regulations applicable to travel and to the business operations of tourism-related firms inhibit the expansion of international tourism. According to Edgell (1999), the value of the international travel market would be even greater were it not for the large number of non-tariff restrictions affecting travel and tourism services.

Over the last four decades, a structure of international rules on trade in goods has been negotiated, and this has helped to bring about freer trade in merchandise; however until 1993, there was no prospect for a similar structure to facilitate trade in services.

Bull (1998) states that tourism regulations may be imposed by government bodies for a variety of reasons such as consumer protection, orderly markets or as part of macroeconomic policy. They generally cover such questions as:

- Who may supply a good or services?
- What quantity of products or money may be traded?
- What prices may be set?
- Under what conditions may production and exchange take place?

The economic impact of government financial and trade policies on international trade in tourism and on the tourism industry has never been measured. Nevertheless, there are compelling reasons to suspect policies may affect the tourism industry more negatively than they do other commercial activities and other industries.

The sale of tourism services internationally is unlike trade in goods, where the merchandise is sold and shipped to the foreign market. It is also unlike trade in other services, such as insurance, banking or consulting, wherein the provider exports the service by making it available in the foreign market. An hotelier cannot float his or her hotel to a foreign country and sell accommodation to those country residents' or visitors-because his or her product is stationary. Even an airline, which owns portable working assets, is rarely permitted to sell available seat miles between points within a foreign country; it can export transportation only to those foreign nationals who are leaving or returning to their own country. Tourism services can be exported only if a resident of one country visits another country.

Financial and trade policies that prevent or deter a national tourism market from travelling abroad therefore severely limit the export ability of foreign tourism enterprises. Goods exports would be affected in a comparable manner only if government prevented the importation of foreign-made goods altogether or imposed such restrictive quotas that meaningful trade could not occur.

Another reason why government financial and trade policies may affect tourism more negatively than other industries is that tourism services, unlike goods and many other services, as discussed before are highly perishable. They cannot be stored in inventory for future sale if not sold when offered. A hotel room-night, if unused, perishes at checkout time the next day. Unused available seat-miles expire once an aeroplane takes off. If trade barriers prevent or deter a market from being created at the time that the service is offered, the value of the service expires, contributing nothing to cover the cost of the provider's investment. Unused service, however, by virtue of being offered, adds to the investor's fixed overhead and sunk cost.

3.12 RESTRICTIONS TO INTERNATIONAL TRADE IN TOURISM

The barriers confronting international tourism are many and varied. Some are peculiar to individual aspects of tourism, such as customs regulations, documentation formalities, and regulation affecting transportation, lodging and travel agencies. Some are more general in nature and apply to several aspects of tourism, such as market access and operation of subsidiary companies. According to Edgell (1999), most of the obstacles do not lend themselves to quick solutions, particularly when action is required by national legislatures or other deliberative bodies.

3.12.1 ADMISSION RESTRICTIONS

Special admission restrictions may be imposed by countries to regulate tourism, or its effects. Iran refuses both admission and transit to women not wearing Islamic head cover, scarf, long sleeves, or stockings. Libyan law denies entry to women married to nationals of Arab League countries travelling without their husband, unless holding a No Objection Certificate (NOC) issued by the Libyan Immigration Department and they are met upon arrival by the resident relative who applied for the NOC, or unless travelling to join their husbands and they are met upon arrival by their husbands. The passenger must hold a telegram specifying that the husband is waiting at the airport of the destination and must submit a marriage certificate if travelling in a single status. Syria refuses admission to all female nationals of Afghanistan, Bangladesh, the Philippines, Sri Lanka, and Thailand, even if holding a visa, unless they have written approval from the head of immigration at Damascus.

With respect to denial on the basis of appearance, Singapore reserves the right to deny entry to visitors with long untidy hair and dressed in an offensive manner. The Dominican Republic refuses entry to nationals of any country if they are members of the religious group "Hare Krishna", and persons with long hair, beard, moustache, or highly informal clothing and those under suspicion may be subject to a body search.

Where behaviour is the basis for denial, Saudi Arabia denies admission to travellers arriving in an apparent intoxicated state, women exposing legs or arms, or wearing too thin or too tight clothes, men wearing shorts exposing legs, and men and women displaying affection in public in any manner.

Another government concern is immigration control. Nearly all countries strictly control the entrance of immigrants and enforce lows against illegal entry. Of particular concern are the social pressures created by the need to care for jobless immigrants and opposition of the local work force when jobs are scarce.

3.12.2 EXIT RESTRICTION

Some governments establish exit restrictions to curb outbound travel to other countries and to serve political-economic objectives. By demanding that its nationals obtain permission to leave the country, an authoritarian government can:

- Ensure that they are not exposed to democratic self-rule or alternative economic system;
- Muzzle opposition leaders whose views might embarrass the regime if communicated to the free press in other countries;
- Demonstrate its displeasure with and disapproval of the policies of other governments;
- Protest at what it believes to be discriminatory admission restrictions imposed on its citizens by another government or governments;
- Limit the amount of exchange flowing out of the country and into the tourist industry of an unfriendly nation.

A number of political, economic and social factors influence government actions and regulations for exit restrictions for tourism. Travel advisories are issued or bans are imposed from time to time for political reasons. It is common, for example, for governments to prohibit travel to war zones or to territories of hostile nations in which the government has no means of protecting the life and property of its citizens. Special precautions also may be taken when outbreaks of contagious diseases occur in foreign countries, and these measures may result in discouraging or inconveniencing tourists. Some burdensome practices, such as inspections of luggage and body searches, may be instituted for passengers' safety and security and to prevent smuggling.

3.12.3 IMPORT RESTRICTION

In some cases, international policies or religious consideration determine types of goods and how much a government will permit a traveller to bring home. For example, Libya prohibits, among other things, goods of Israeli origin and certain makes of records and taps.

3.12.4 ECONOMIC CONTROLS ON TOURISTS AND TOURISM BUSINESSES

Most direct economic controls on tourists themselves are imposed as a part of balance of payments policy. There is rarely a need to regulate domestic tourism, which merely shifts income within an economy. Those countries, which see international tourism as an important contributor to balance of payments flows, may impose foreign exchange restrictions in addition to the use of taxation and complex documentary requirements.

Effective demand for foreign tourism can be restricted in generating countries by exchange control regulations limiting the amounts of both domestic currency and foreign exchange, which may be personally exported. Although during the 1980s most generating countries had non-restrictive controls or no limits, this is not always the case. Of course, tourists and suppliers attempt to circumvent restrictions. VFR traffic increases as tourists attempt to maximise trips without needing large amounts of exchange for accommodation. If regulations apply to a significant generating market, suppliers may attempt to integrate foreign tourism products and sell its in the home currency. The United kingdom's V-form travel allowance in the 1960s and 1970s increased tour operators' markets, as they were able to package overseas with only a small component of foreign exchange required (Holloway, 1994), and sell a product for which tourists were unable to purchase the separate components independently.

Countries may effectively restrict foreign business tourism by controlling its tax deductibility. If a trip is tax deductible, the cost to the purchasing enterprise is the price less the marginal corporate tax rate. To reduce non-essential business travel (both domestic and foreign), governments limit deductibility. The United States government, for example, normally restricts deductibility to the daily travel allowances provided for government employees. This can limit consumption of incentive travel, or convention tourism to expensive destinations.

Destinations may also impose regulations on tourists in the form of compulsory currency exchange. In 1994, this applied to some 17 countries. A visitor to Tanzania, for example, must exchange a minimum daily amount of convertible currency in to local units, and on leaving the country may reconvert only a proportion of that exchanged. As local currency export is prohibited, this forces a minimum level of expenditure per tourist per day. Normally these levels are not substantial unless a destination authority wishes specifically to discourage low spending, backpacker market segments.

Government monetary and financial policy goals operate to the disadvantage of foreign-owned travel and tourism businesses. Exchange controls and restrictions on remittance of earnings tend to discourage the establishment of businesses by non-nationals. Investment laws, which require minimum ownership by local nationals, are intended to promote domestic economic development. Restrictions on the use of foreign-made promotional and advertising materials also are intended to stimulate local business enterprise. Discrimination against the activities of non-established businesses often is designed to encourage inward investment and employment of local nationals. Foreign companies are excluded to assure full control of the business.

Two of the main issues for tour operators, travel agents and other tourism business are denial of market access to foreign companies and discriminatory treatment of subsidiaries of foreign companies. In addition, of major concern to tourism and other service-oriented business are restrictions to trans-border data flows affecting information on flight, hotel and tour availabilities and reservations. Other important issues for international tourism are overly restrictive foreign exchange controls and limitations on the transfer of funds and repatriation of profits.

For travellers, and consequently for travel and tourism businesses, another set of important issues are those which constitute disincentives to international tourism and to purchases by tourists while abroad. These include difficulty in obtaining visa and passport approval, restrictive duty-free allowances for returning residents, and travel delays and inconveniences caused by discriminatory treatment of airline ground handling and computer systems.

The main question is what can be done to reduce or eliminate these obstacles to international trade in tourism and to ensure that at least the GATT countries do not impose new measures that would adversely affect tourism businesses? It is clear that unless the GATS is successful in facilitating tourism, tourist companies will continue to be unable to market their services adequately.

The General Agreement on Trade in Services (GATS), which was negotiated during the Uruguay Round, was finally agreed by 118 countries on January 1995. The main objective of the GATS is reducing and eliminating some of the obstacles to international tourism. It is the first multilateral, legally enforceable agreement covering trade in tourism services sector. It provides a specific legal basis for future negotiations aimed at eliminating barriers that discriminate against foreign services providers and deny them market access.

3.13 ARGUMENTS FOR TRADE BARRIERS

3.13.1 INFANT INDUSTRY

The oldest existing argument for protection is the infant-industry argument. It was forward in the 1840s by the German economist and politician Fredrick list (Baumal & Blinder, 1991).

The core of the infant industry argument is the existence of some kinds of international economies. An industry just starting up cannot compete if it is small. It has to be large before it can harvest all the economies of scale in production and become competitive. Therefore it has to be protected for some time during its infancy and be permitted to grow, without meeting immediate competition until it can meet foreign competition, achieve economies of scale, and reflect the nation's long run comparative advantage.

According to Grimwade (1989), another issue is that there may also be a learning curve. It takes some time for managers and workers in a new industry to establish efficient operational and working practices. Only by protectionism, the new industry cannot compete until the learning benefits come through. Once the infant industry is sufficiently large and fully developed, tariff barriers can be removed and free trade can be allowed. This is the essence of the argument.

This argument is not as persuasive as it first seems, as Anderson (1998) states that it is not enough to show that present losses have to be incurred if further gains are to be had. This is itself, no argument for protectionism, because if a capital market exists and functions properly, and if domestic producers have a correct view of the profitability of the investment, they will invest in the industry even without a tariff.

In general, infant industries will not grow successfully behind trade barriers. One problem is that government needs to be able to identify those infant industries which will grew successfully. Second, industries protected by trade barriers lack the competitive pressure to become efficient. Third experience has shown that protection, once given, is difficult to remove. So the infant industry argument has to build on a more intricate case than this (Tharaken, 1995).

3.13.2 DOMESTIC FULL EMPLOYMENT ARGUMENT

Another argument with a very long history is the idea that protectionism can create or at least preserve jobs. This idea causes governments to impose restrictions on imports (Mikic, 1998).

Full employment is an elusive objective even with respect to its definition and measurement; it has been a high-priority goal of national government for the past 40 years. The possibility of a conflict between domestic full employment and unrestricted trade with the rest of the world is a concept that can be deceptive in its apparent obviousness and validity.

Salvatore (1983) states that the idea can assert itself appealingly whenever a nation is experiencing a high rate of unemployment while simultaneously importing goods from foreign countries. In such a situation, curtailing imports through government controls may appear to be a "quick fix" for the unemployment problem, since this presumably would shift domestic demand from imported goods (produced by foreign labour) to domestically produced substitutes and thereby create more jobs at home.

A government suffering unemployment may be tempted toward this action. However, there are two major problems with this policy, firstly a nation's attempt to generate employment by reducing imports may be accompanied by corresponding losses of jobs in sectors of the economy connected to exports. Any country is apt to find it difficult to cut imports through direct governmental controls without also experiencing a reduction in export sales. Secondly the attempt to generate tariffs by imposing trade restrictions may have other effects. One of these would be a forced reallocation of resources within the economy, which is apt to be disruptive while it is occurring and inefficient when it has been effected. As noted above, import restrictions designed to raise the level of domestic employment frequently result instead in trading off existing jobs in export - related industries. For new jobs in import substitution industries, this process is likely to prove difficult and wasteful. Since it entails installing new production facilities and training workers to produce goods to replace imports, at the same time established productive capacities and experienced workers are being ideal in other sectors of the economy.

Furthermore, the reallocation process would be misdirected from the stand point of overall economic efficiency, as it would reduce production in industries with a proven comparative cost advantage while increasing production in industries that must be insulated from import competition in order to survive.

Despite all these potential pitfalls, national government still imposes restriction on imports as a remedy for unemployment.

3.13.3 NATIONAL SECURITY

There are times when a tariff or other measure to interfere with trade may be, justified on non-economic grounds. Winters (1996) argues that national defence is most frequently used as a non-economic reason. This argument relates to political rather than economic considerations.

National security refers to the preservation of the nation as a sovereign and independent political entity. Most countries are striving either to attain or maintain this condition of political autonomy, and this strongly influences their international economic policies.

Government may perceive a conflict between maintaining national security and allowing free trade. Indeed, this potential may be regarded as inherent and virtually inescapable, since international trade grows out of and intensifies national specialisation in productive activity. While such specialisation can yield immense economic benefits, it also leads inexorably towards greater economic interdependency, as each nation fore goes domestic production of some goods in order to concentrate on producing those in which it holds a comparative advantage. In an ideal political environment of peace and goodwill among nations, such interdependency would be quite acceptable. However in our imperfect political world, it is reasonable for national leaders to conclude that the dependency resulting from trade can make their country vulnerable to external economic pressures or hostile political acts.

Nations may become overly dependent on foreign sources of raw materials or products. Having those supplies cut off in times of war or other political disturbances is a threat that has pre-occupied government leaders for countries.

According to the World Bank (1990), there is much historical evidence to reinforce such concern, for example the oil crisis in 1973 when oil exporting countries raised the price of the oil four times in order to manipulate the policies of the countries that supported Israel in the October War 1973.

Efforts to guard against such a danger appear in national policies toward foreign trade as a restriction on imports. The ostensible intent of such restrictions is to create a domestic capability to produce the commodities or products involved or usable substitutes for them and thereby to reduce the nation's vulnerability to supply interruptions.

Although reason and experience may justify some restrictions on trade, the argument for national security can be easily abused. The OECD (1998c) states that when protection for "national security" reasons is sought by producers of shoes, fish netting or even candles, then it must be obvious that the real motivation is strictly protectionist.

Trade restrictions introduce distortion in the goods and factor markets and an efficiency loss as well. Thus if some production is really needed for national security reasons and trade can not survive without government aid, the best aid will be a production subsidy under free trade. In this case the efficiency loss is smaller.

3.14 SUMMARY

This chapter examined the development of trade theory as well as international trade policy and their implication for tourism industry. The chapter showed that there are gains from trade based on a rational pattern of international specialisation; it was also indicated what the trade structure would be under free trade. The theory of comparative advantage shows that trade between countries will be mutually beneficial if relative costs of production differ, so the theory developed by David Ricardo suggests that free trade is the optimal trade policy because it maximises a country's welfare.

Despite the mutual gains from international trade, the chapter showed that the countries of the world often interfere with the operation of free international markets. Governments have always attempted to control trade to at least some extent.

The discussion also showed that international tourism can be examined using economic theories relating to trade, industrial economics and growth. The chapter showed how market structure is important in determining patterns of specialisation in production and trade at the international level. Within the competitive market structures, which apply to some components of tourism as well as to other products, relative technological efficiency and/or factor endowments are key variables. The earlier discussion of the determinants of trade indicated that developing countries can use their natural and cultural resources as the basic for tourism supply. The ready availability of low-wage labour may also contribute to the growth of labour-intensive tourism production.

Under the imperfectly competitive market structures, which relate to some components of tourism, product differentiation and market segmentation are of particular relevance.

CHAPTER FOUR

THE WORLD TRADING SYSTEM AND THE WORLD TRADE ORGANISATION (WTO)

4.1 INTRODUCTION

Fifty years ago, the world emerged from the ravages of the Second World War. The challenge at that time was to rebuild economic stability in a world of pervasive disorder and massive dislocation, to restore a sense of world community and to establish the basis for future growth and prosperity. The architects of the new system had to build from the ground up, on multiple fronts simultaneously, and they showed vision and far-sightedness. The latter half of the 1940s was not just about the end of the most destructive war ever waged; it was also about the curbing of destructive economic nationalism and the search for a new global order (EIU, 1995b).

According to UNCTAD (1998b), today we once again face a new kind of world and a new set of challenges. The end of the Cold War and the collapse of command and control economies, the dramatic rise of many developing countries, and the massive increase in trade and investment flows around the globe have greatly expanded the frontiers of the multilateral trading system, and tested its ability to mange an economy of global dimensions. The creation of the WTO in January 1995 was a symbol of the acceptance of a more global economic system.

According to Parker (1998), during the past decade, liberalisation has been the hallmark of economic policy throughout the world. In all counties, external transactions have been a key component of liberalisation strategies. This is because liberalisation of international trade, investment and capital movements can improve allocative efficiency and can bring about greater dynamism in an economy, thus providing faster economic growth. According to UNCTAD (1999d), among the expected benefits of increased openness to trade are the improvements in innovativeness and productivity of domestic firms due to external competition.

Consumers also gain from the wider choice of goods and services and reduced prices resulting from increased international competition and specialisation. Economies open to competition from abroad are also presumed to be better able to adjust to adverse external shocks, and less prone to wasteful rent-seeking. At the same time, the increased mobility of factors of production-especially capital and, with it, technology can help a country overcome the dangers of being trapped by static comparative advantage and achieve the continued shifts in its resource endowments required for sustained economic growth and productivity gains.

Further, according to the IMF (1997b), the liberalisation of capital movements means that the link between domestic savings and domestic investment can be relaxed: that is, domestic investment need not be constrained by weak domestic saving behaviour and, conversely, high domestic savings should flow abroad where they are demanded.

On the other hand, the WTO (1998d) argues that success in free trade is not static. The ability to compete well in particular products or services can shift from company to company when the market changes or new technologies make cheaper and better products possible. Experience shows that competitiveness could also shift between whole countries. A country that may have enjoyed an advantage because of lower labour costs, or because it had good supplies of some natural resources, could also become uncompetitive in some goods or services as its economy develops.

However, with the stimulus of an open economy, the country can move on to become competitive in other goods or services. This is normally a gradual process. When the trading system is allowed to operate without the pressures of protectionism, firms are encouraged to adapt gradually and in a relatively painless way.

According to the World Bank (1999b), two basic ideas, as vital today as they were in the late 1940s, have underpinned the system's success over the second half of this century. One is the belief that an open international trading system, and its role in promoting economic prosperity, is essential to international peace and stability. That economic order must be at the foundation of any new political and security framework. The architects of the post-war system agreed that the only route to economic reconstruction and recovery lay in progress towards an open market and liberalised trade, and the experience of 50 years has proved them right. The second idea is that stability and predictability in international trade relations can only be secured through a mutually agreed system of rules, binding all member governments and enforceable through dispute settlement.

According to GATT (1994), the centrepiece and guiding idea of the rules-based system is non-discrimination. This rose out of the conviction that exclusionary deals and preferential blocs helped to fuel the inter-war rivalries, insecurities, and conflicts that drive the international community into another world war. The non-discrimination principle was key to the system's stability in subsequent years.

According to Bagwell and Staiger (1998), the non-discrimination principle plays an important economic role as well; it is an efficiency principle, both in the sense of ensuring access to low-cost supplies, and of allowing producer to sell in foreign markets without a policy-imposed disadvantage relative to other suppliers. Similarly, in a non-discriminatory policy environment, customers can choose freely from among alternative foreign sources of supply. In a world of differentiated, discriminatory trade regimes, doing business across frontiers becomes more complex and time-consuming, implying additional costs for enterprises and impaired competitiveness. For both political and economic reasons, then, the non-discrimination principle has served countries well over the last 50 years, be they large or small, developed or developing.

Lazear (1999) states that liberalisation has, however, proceeded at different speeds and in different ways as far as trade, investment and finance are concerned. Multilateral trade liberalisation, a process that began with the establishment of GATT some 50 years ago, has taken a decisive step forward with the completion of the Uruguay Round, which has dramatically reduced tariffs and removed quota obstacles that traders encountered at the borders of all groups of countries; these reductions furthermore have been bound into multilateral contractual commitments with the possibility of recourse to workable dispute settlement mechanisms. Moreover, the major results of the Uruguay Round were the establishment of new agreements, which discuss trade in services, agriculture, and intellectual property, which are of particular importance to developing countries.

Solutions to the challenges facing countries today and in the future will, as always, call for concerted action on a variety of fronts. Considering how the trading system can contribute to meeting these challenges, it is useful to study what the system has achieved so far, what changes have taken place in the system, and who the losers and the winners are in the new system.

4.2 THE HISTORY OF GATT: AN OUTLINE

4.2.1 BACKGROUND OF GATT

According to Winters (1996), in the period between the first and the second world wars there was a marked deterioration in international economic relations. In the 1920s an attempt was made to go back to "normal" conditions. This meant the gold standard, as far as international monetary co-operation is concerned. An attempt was also made to organise world trade on a liberal basis.

According to Bö Sodersten (1985), this system did not function well. Britain, for instance, had difficulties because of an overvalued currency, and when the depression came at the beginning of the 1930s, the system broke down. Competitive devaluations followed, and trade restrictions were introduced. Many countries reverted to an autarkic pattern of production, and trade on a bilateral basis was introduced.

WTO (1998d) states that at the end of the Second World War the inter-war period was still fresh in the memory. When the victorious countries (especially Britain and United States) started to plan for new, more viable relations in the international economy, they were determined to avoid the mistakes of the past. The Bretton Woods Conference held in 1944 was the starting point for a new order. The world economy would be organised around three cornerstones: the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD) and the International Trade Organisation (ITO).

Grimwade (1989) states that the IMF was designed to take care of short-term problems in connection with international liquidity. It would help to smooth out difficulties that countries might have with their balances of payments. The IBRD would help to channel international investments along desired lines. It would especially help the countries most in need of capital, the less developed countries, to get capital from the more developed, industrial countries. On the other hand, the ITO would deal with the real side of trading relations. It would help to create a liberal system of regulations governing world trade; it would, in the long run, be the vehicle that carried the world toward a system of free trade.

According to Jackson (1990), attempts at guiding the world economy have met with varying degrees of success. The International Trade Organisation was the least successful organisation; it never actually came into existence. A conference in Havana in 1947-48 established a charter for the ITO, which was never ratified by the US Senate or any other country. Instead, GATT came into being. GATT was a less ambitious organisation with headquarters in Geneva. It would serve as a sort of clearinghouse between nations. Instead of negotiating on a bilateral basis, the member countries of GATT would meet in Geneva and negotiate jointly at the same time on matters of trade policy. Thereby, it was hoped, a more orderly and just result could be achieved (WTO, 1998d).

4.2.2 THE ORIGINS OF GATT

The GATT is a multilateral agreement between trading nations. It provides a set of rules for the conduct of international trade and is the forum in which worldwide negotiations take place.

The major initiatives leading towards the GATT were taken by the United States during the World War II, in co-operation with its allies, particularly Great Britain.

According to Jackson (1990), there were two distinct strands of thoughts that influenced those countries during the war period.

The first of these strands stemmed from the programme of trade agreements begun by the United States after the enactment of the 1934 Reciprocal Trade Agreements Act. With this act, the United States Congress delegated power to the US President to enter into reciprocal agreements in order to lower tariffs. Under this authority, renewed from time to time, the US by 1945 had entered into 32 bilateral agreements reducing tariffs. Later versions of these agreements contained most of the substantive clauses subsequently found in GATT.

The second strand of thinking during the war period, stemmed from the view that recent mistakes concerning economic policy were a major cause of the disasters that led to World War II. The Great Depression has been partly blamed for the war, as has the harsh reparation policy towards Germany. Between the wars, and particularly after the damaging 1930 US Tariff Act, nations took many protectionism measures, including quota restrictions, which choked international trade.

Political leaders in the US and elsewhere made statements about the importance of establishing post-war economic institutions that would prevent these mistakes from happening again. The Consumer Council (1995) states that to this end, the United States invested vast sums in the Marshall plan to help the defected nations achieve economic growth and stability. The Organisation for European Economic Co-operation (OEEC) (renamed in 1960 the Organisation for Economic Co-operation and Development, (OECD) was formed primarily to distribute the Marshall Plan funds, and then to liberalise trade among its member states, in particular, through the removal of quantitative restrictions.

4.2.3 THE GENERAL AGREEMENT ON TARIFF AND TRADE AND HAVANA CHARTER (ITO)

According to Jackson (1990), the Bretton Woods Conference, held in 1944, was devoted to monetary and banking issues, and it established the charters of the IMF (International Monetary Fund) and the World Bank (International Bank for

Reconstruction and Development), but it did not take up the problems of trade as such. The conference was held under the jurisdiction of ministries of finance, who were not responsible for trade. Nevertheless the 1944 conference is on record as recognising the need for a compatible institution for trade, to complement the monetary institutions.

The United Nations was set up in 1945, and in February 1946 its subordinate body adopted, at the first meeting, a resolution calling for a conference to draft a charter for an "International Trade Organisation". The United States at this time published a draft ITO charter and a preparatory committee was formed and met in October 1946 in London. The principal meeting was held in Geneva from April to November 1947, and was followed by a meeting to complete the ITO charter in Havana, in 1948. The history of the preparation of GATT is intertwined with the preparation of the ITO charter. Jackson (1990) states that the 1947 Geneva meeting had three major parts:

- One part was devoted to continuing the preparation of a charter for a major international trade institution, the ITO;
- A second part deals with the negotiation of multilateral agreement reciprocally to reduce tariffs;
- A third part concentrated on drafting the general clauses of obligations relating to the tariff obligations.

According to Jackson (1995), these latter two parts together would constitute the general Agreement on Tariffs and Trade (GATT). The first part, the charter for International Trade Organisation, went to the Havana conference in 1948 and was signed by more than 50 countries; but the United States Congress refused to approve it and it did not materialise.

The general clauses of the draft GATT imposed obligations on nations to refrain from a variety of trade-impeding measures. GATT (1990) states that many of these clauses had evolved in the US bilateral trade agreements, and were seen as necessary to protect the value of any tariff-reducing obligations. The GATT, however, was not intended to be an organisation. Indeed, United States negotiators were criticised by committees of the US Congress in 1947 for tentatively agreeing to clauses, which seemed to imply an organisation.

Jackson (1995) states that the US President and his negotiators recognised that an ITO charter would have to be submitted to Congress for approval. But from the US point of view, the GATT was being negotiated under the 1945 extension of the trade agreement authority. The Congressional committees pointed out that this 1945 Act did not authorise the President to enter into an agreement for an organisation, it only authorise agreements to reduce tariffs and other restrictions on trade. So the US negotiators returned to Geneva and redrafted the general GATT clauses to avoid the suggestion of an organisation. Thus multilateral decisions under GATT are taken by the Contracting Parties acting jointly and not by any organisation.

4.3 HOW THE GATT WORKS

4.3.1 GATT STRUCTURE AND FUNCTIONS

4.3.1.1 GATT Objectives

The GATT is an intergovernmental body with a permanent secretariat based in Geneva (see table 4.1). The GATT, initialled by twenty-three nations in 1947, has proved remarkably robust and durable. GATT remains the dominant vehicle for negotiating multilateral reduction of trade barriers and for constraining further trade restriction. The characteristics of international trading relationships have nevertheless changed dramatically over the post-war period.

Table 4.1: The Institutional Framework of GATT

The Institutional Framework of GATT
The Council
Composed of all "Contracting Parties", it meets every five or six weeks in Geneva. This is also the management committee, so standing committees and policy bodies report to it. The main agenda item is the disputes system.
Standing committees
Group1: includes committees on trade and development, and trade in meat and dairy products. One of the most important is the textiles surveillance body which overseas the multi-fibre arrangement.
Group 2: committees set up as a result of the Tokyo Round to deal with resulting agreements and handle disputes. Co-ordinated by a trade negotiations committee.
The annual session
The main decision-making forum of the GATT. It considers accession of new Contracting Parties, waivers to GATT articles, reports from committees and tariff concession. Each Contracting Party has one vote, although decisions are normally reached by consensus. Voting by a two-thirds majority is required to waive any GATT obligation.
Membership
Government officials participate at all standing committees and negotiating committees and most meetings of the annual session and the council (although some are attended by trade ministers). Observer status has been granted to non-signatory countries, UNCTAD and WHO.

Source: GATT (1980)

Greenaway et al (1988) state that there are three fundamental objectives to the creation of the GATT:

1. To provide some kind of orderly framework for the conduct of trading relations. This could reasonably be regarded as a short-term objective, in the same sense that the presence of a charter would ensure that trade relations did not take up from where they left off in the 1930s.

2. To provide a system of rules and codes of conduct which would make it more difficult for individual nations to take unilateral action and which would therefore minimise the risks of a repetition of the 1930s.

3. To provide a framework for the progressive elimination of trade barriers.

According to Anderson (1998), implicit in these objectives is a judgement about economic efficiency and equity. The former is embodied in the recognition that the interests of the system are best served by freer rather than more restricted trade, and a movement towards this implies that resources will be more efficiently allocated and participating countries will enjoy real income gains from exchange. It could be argued that, where considerations of equity are concerned, the provision of a set of rules and regulations could be expected to benefit the weak relative to the strong, in so far as it reduces the risk of unilateral action on the part of the latter.

4.3.1.2 GATT Functions and Framework

EIU (1995b) states that the General Agreement is a very complex, detailed and technical document which sets out the rules for the conduct of trade between the members and the many exceptions to these rules which political necessity requires. The GATT treaty is divided into four parts:

- Part one (Articles I and II) contains the Most Favoured Nation (MFN) clause and the obligation for tariff commitments. The Most Favoured Nation (MFN) rule embodied in Article one is probably the most important principle of the GATT. Its aim is to ensure that any trade concession must be extended to all other contracting parties.

- Part two (Articles III to XXIII) deals with the National Treatment obligation; the procedures used to liberalise world trade, and the dispute settlement procedures to be applied in cases of disagreement between member countries. It also sets out the conditions under which anti-dumping duties to protect the balance of payments, or duties to safeguard domestic industry can be used.

- Part three (Articles XXIV to XXXV) lays down the accession procedures and the status of customs unions in GATT.

- Part four (Articles XXXVI to XXXVIII) was added in 1965. It commits developed countries to assisting developing countries. It also lays down the important principle, subsequently elaborated during the Tokyo round, that developed countries also agreed to refrain where possible from increasing barriers to exports of primary and other products of special interest to developing counties, and to give high priority to reducing existing barriers, including taxes. This is known as "special and differential treatment".

In addition there are a number of GATT codes, agreements and arrangements on particular issues, which have been developed over the years to meet changing circumstances.

4.3.2 THE PRINCIPLES OF GATT

According to the GATT (1986), the GATT sought to provide a framework for the orderly conduct of trading relations and for the progressive elimination of trade barriers. A number of basic principles underpin these obligations; these include non-discrimination, reciprocity and transparency.

4.3.2.1 Non-discrimination

According to GATT (1994), the basic principle of the GATT is that of non-discrimination. Countries that belong to GATT must accept the Most Favoured Nation clause (MFN) and the National Treatment obligation.

4.3.2.2 Reciprocity

Allied with the principle of non-discrimination is a concern for reciprocity. Membership of GATT, and trade negotiations under it, are generally conducted in terms, which are reciprocal or are intended to achieve mutually advantageous outcomes.

According to the WTO (1995b), the reciprocity obligation requires a country accepting a tariff concession to offer a comparable concession in return. The reciprocity obligation helps to create domestic producer lobbies with an interest in lowering their own countries' trade barriers. Exports industries will anticipate benefits, i.e. more exports, following the offer of concessions that are reciprocated by the countries to which they export. Thus this principle serves to contract the domestic political influence of producer lobbies with an interest in resisting tariff liberalisation.

Bö Sodersten (1985) argues that, to some extent, MFN and reciprocity are conflicting principles: strict or unconditional adherence to non-discrimination would permit free riders and thereby undermine the incentives to multilateral liberalisation provided by reciprocity. But, in what is after all ultimately a negotiating framework, compromises allow the obligations not to be rigidly enforced. Differences in countries "ability to offer" concessions are implicit in the negotiation processes, and are explicitly recognised in specific exceptions embodied in other articles of the General Agreement. At this stage, it is important to emphasise that the core principles of GATT, namely of non-discrimination and reciprocity, are underpinned by the logic that governments perceive benefits primarily from increased exports rather than unilateral free trade.

4.3.2.3 Transparency

According to GATT (1980), the transparency principle, Article II, outlaws the use of direct controls of trade flows, in particular the use of quotas and similar quantitative restrictions. One of the reasons for this is the desire for greater transparency: that is, for the use of instruments whose economic effects are more visible and more certain. GATT incorporates the liberal sentiment that price signals allow markets to operate effectively and therefore efficiently.

Given that the initial signatories of GATT at the start of the post-war period were largely the non-communist industrial market economies of North America and Western Europe, such a sentiment is not surprising. These countries had, in any case, experienced the illiberal policy environment of the inter-war period, and the GATT principles were strongly fashioned by the desire to avoid repetition of that experience.

4.3.3 EXCEPTIONS OF THE GATT PRINCIPLES

Greenaway et al (1988) state that there are permitted exceptions to each of the principles discussed above, exceptions that derive from a recognition that short-term exigencies may require exceptional measures, or that political constraints may impose limits on the freedom of individual governments to act. The most significant exceptions are the temporary balance of payment difficulties, and the need temporarily to protect the domestic industry from market disruption. It was also recognised that there may be circumstances when departures from the MFN principle are permissible.

There are exceptions, however, to the transparency and other principles such as MFN. The most important exception to tariff liberalisation according to the MFN criterion is contained in Article XXIV, which lays down rules for the establishment of free trade areas and customs unions, within which preferential treatment may be accorded to co-partners. Another important exception is to allow regional integration; this was aimed originally at encouraging reconstruction in Western Europe. According to Baumol and Blinder (1991), the significance of these exceptions to the general rules tends to change with the passage of time and changes in economic circumstances.

4.3.4 GATT MEMBERSHIP

The GATT (1980) states that since the GATT is not an organisation, it does not have members; the terminology used in the agreement itself is Contracting Party (CP).

Nations become GATT CPs by one of two methods: The normal method of accession is governed by Article XXXIII of GATT and requires a two-third vote of approval by the existing Contracting Parties. The applicant nation must negotiate tariffs or other concessions which existing GATT CPs deem adequate to fulfil reciprocity to existing GATT concessions. It would be unfair to let a nation enter GATT and receive the advantage of over 40 years of various trade concessions and obligations, unless it committed itself to equivalent obligations. This is sometimes referred to as negotiating the "ticket of admission".

A second path to GATT membership is Article XXVI, paragraph 5 (C), which provides that if a parent country of a dependent customs territory has accepted the GATT such a territory can become a GATT Contracting Party merely through sponsorship from the parent country (GATT, 1980).

4.4 DISMANTLING THE OLD PROTECTIONISM

According to Williamson and Milner (1991), the GATT does have a continuing or day-to-day role in seeking to maintain an orderly framework for trade. It provides information and conciliation services and has a research department. But the GATT secretary is modest by international agency standards, and it is the outcome of the "round" of trade negotiations conducted under the aegis of GATT that is the tangible and publicised GATT activity.

The tariff-negotiating round of GATT, since 1947, has been the reduction of tariff levels among the Contracting Parties. For the most part, this has occurred as a result of eight intensive negotiating rounds, beginning in Geneva in 1947. Jackson (1990) states that, as a result of these rounds, tariffs on industrial products imported into the industrial nations have been reduced to a point where, in the view of some economists, they are no longer significant, with a few exceptions. The exceptions include "peak levels" of particular products where tariffs remain high, and also include certain relationships between close neighbour trading partners (such as the US and Canada), where even a few percentage points of a tariff can influence investment and other economic decisions.

Since quotas were outlawed in principle from inception, attention has always been focused on reducing the tariff rates inherited from the pre-war period. The negotiators who gathered in Geneva in 1947 to sign the General Agreement also agreed to make tariff concessions on items covering about one-half of world trade at that time. Item by item bargaining continued in a number of subsequent rounds through the 1950s and the early 1960s.

In the early rounds, item-by-item bargaining proved acceptable because it permitted negotiators to select items for concessions where tariff redundancy allowed liberalisation with limited need for adjustment, but countries with relatively low tariffs were concerned that a continuation of the item-by-item process would leave them in an exposed position relative to countries with high tariffs.

Salvatore (1983) states that greater success in tariff reductions was not achieved and the pace of trade liberalisation associated with the early rounds could not be maintained, due in part to cumbersome nature of item-by- item bargaining on a multilateral basis, and because in the 1950s the US Congress attached serious protectionist devices to the periodic renewals of the Trade Agreements Act. These protectionist devices were:

1. Peril-point provisions, which prevented the President from negotiating any tariff reduction that would cause serious damage to a domestic industry.

2. The escape clause, which allowed any domestic industry that claimed injury from imports to petition the International Trade Commission, which could then recommend the President to revoke any negotiated tariff reduction. A rising share of imports in an industry was sufficient to prove injury.

3. The national security clause, which prevented tariff reductions (even if already negotiated) when they would hurt industries important for national defence.

Ethier (1998a) states that as a response to dissatisfaction with item-by-item negotiation, it was suggested as early as 1951 that tariffs be lowered on an across the board basis, and that the reductions should be planned and staged. This proposal was not endorsed by the US or Britain, and the continental European nations channelled their energies into economic integration instead. The outcome was the creation of the EEC in 1956 and the European Free Trade Area (EFTA) in 1959. This preoccupation with regional liberalisation undoubtedly undermined interest in multilateral liberalisation via GATT in the 1950s.

Table 4.2 summarises the eight trade negotiating rounds. According to GATT (1980), tariffs were reduced by a total of about 35 percent in five different trade negotiations between 1947 and 1962. In 1965 GATT was extended to allow preferential trade treatment to developing nations to benefit from tariff reductions negotiated among industrial nations without reciprocity.

Table 4.2: GATT Negotiating Rounds

Round	Dates	Number of countries	Value of trade covered
Geneva	1947	23	$10 billion
Annecy	1949	33	Not available
Torquay (UK)	1950-51	34	Not available
Geneva	1956	22	$ 2.5 billion
Dillon	1960-62	45	$ 4.9 billion
Kennedy	1964-67	48	$ 40 billion
Tokyo	1973-79	99	$ 155 billion
Uruguay	1986-93	118	Not available

Source: WTO (1997a)

4.4.1 PRE-KENNEDY ROUND

The process of tariff liberalisation commenced, quite literally, at the inception of GATT. The twenty-three nations participated in the first round (Geneva 1947) agreed to make tariff concessions on some 45,000 individual items, which together comprised about half of world trade at the time (GATT, 1994).

GATT (1980) states that the momentum generated by the initial Geneva Round was maintained by subsequent Rounds held in Annacy in 1949 and Torquay in 1951. By the completion of the Torquay Round, bargains had been struck, resulting in tariff concessions being made on over 58.000 individual items. Between 1951 and 1964, however, progress within GATT was rather limited. There were two further rounds in this period, one in 1956 in Geneva, and one in 1960-61 (the Dillon Round), but relatively little was accomplished by way of further liberalisation.

4.4.2 KENNEDY ROUND (1964-67)

The Kennedy Round of negotiations (1964-67) stands out as something of a landmark in the round system. The Round was far more ambitious than previous rounds, and adopted an across-the-board approach to cuts in tariffs for industrial goods. Tariff concessions covered an estimated total value of $40 billion in trade. Separate agreements were reached on grains and chemical products plus a code on anti-dumping (World Bank, 1995b).

According to the World Bank (1993), there was some dispute over the form, which any across-the-board reduction should take. The US tended to favour a linear cut, which would apply to all commodities. The EEC, on the other hand, favoured some attempt at harmonisation: that is, higher rates of reduction on high-tariff items. Ultimately agreement was reached in 1967 on tariff cuts, which affected about 75 percent of total industrial trade. The average tariff reduction amounted to a cut of something over 36 percent and some degree of harmonisation took place.

Salvatore (1983) states that in terms of tariff liberalisation, the results of the Kennedy Round were quite the most spectacular of any of the GATT rounds to date. There are, however, a number of qualifications:

1. Liberalisation concentrated on industrial goods. Industrial countries continued to protect their agricultural sectors, largely for non economic reasons, and even after the Kennedy Round, agriculture remained a highly protected sector in most industrial countries.

2. There were exceptions among manufacturing goods. Most significant were the relatively low cuts which applied to textiles, a sensitive sector on which special case status had been conferred as early as 1961 by the long Term Agreement on Cotton Textiles. Textiles continued to be excluded from the multilateral liberalisation process.

3. In the pre-Kennedy Rounds, there had been a tendency on the part of the industrial countries to reduce tariffs on primary commodities and raw materials to

a greater extent than on finished goods. The sequence of such a pattern of liberalisation is to raise effective rates of protection on finished goods. Little was done by the Kennedy Round to reverse this process.

Despite these qualifications, the Kennedy Round was in many ways a major step towards freer trade among the industrial countries. With the average tariff on actually traded industrial goods standing at 7.2 percent at the start of the 1970s, the round had succeeded in dismantling much of the old protectionism. However, the special cases identified above created problems for later rounds, while changing economic conditions have created new problems.

According to Williamson and Milner (1991), the process of dismantling the old protectionism mainly involved a relatively small number of industrialised countries and was focused on the liberalisation of trade in industrial goods. This focus on commercial policy negotiations reflected the prevailing pattern of international economic power. But the location of economic was already changing during the 1950's and 1960's, as reconstruction in Western Europe was completed and Japan emerged as a major trading nation. Since the 1960s, the patterns of international trade and economic power have been subject to further substantial changes with three major developments:

- The entry of new competitors into international markets for industrial products;
- The influence of industrial trading blocs on the direction of trade;
- Oil price changes.

4.4.3 TOKYO ROUND: COPING WITH NEW PROTECTIONISM

The World Bank (1990) states that against the background of international monetary crisis and of rising protectionist pressures in the United States, the Nixon administration called in 1971 for a new round of GATT negotiations to be aimed at what the US saw as unfair trade practices.

In 1973, the Contracting Parties met in Tokyo. According to Greenaway et al (1988), the Tokyo Round of trade negotiations was described by Olivier Long, Director General of GATT, as the most complex and far reaching ever undertaken. The negotiations were conducted in the most inauspicious of circumstances (the stagflation of the 1970s) and took place alongside the continued growth of the new protectionism. Ninety-nine countries took part in the Tokyo Round, which took six years to complete (1973-79), a record only broken by the Uruguay Round.

The Contracting Parties agreed to an ambitious agenda, including further tariff liberalisation, special efforts to liberalise trade in agriculture products, reduction of non-tariff barriers and preparation of codes of conduct to prevent unfair practices. As can be seen in figure 4.1, seven groups were set up to consider the following specific topics:

1. Tariff and the appropriate negotiating schemes.

2. Non-tariff measures, covering in sub-groups:
   - Quantitative restrictions (including voluntary restraints);
   - Technical barriers;
   - Custom issues;
   - Subsides and counter-veiling duties.

3. Agriculture, covering:
   - Grains;
   - Meat;
   - Dairy products.

4. Safeguards.

5. The sector approach, that is, to look at the possibilities for co-ordinated reduction or elimination of all barriers to trade in selected sectors.

6. Tropical products.

7. Special and differential treatment for developing countries.

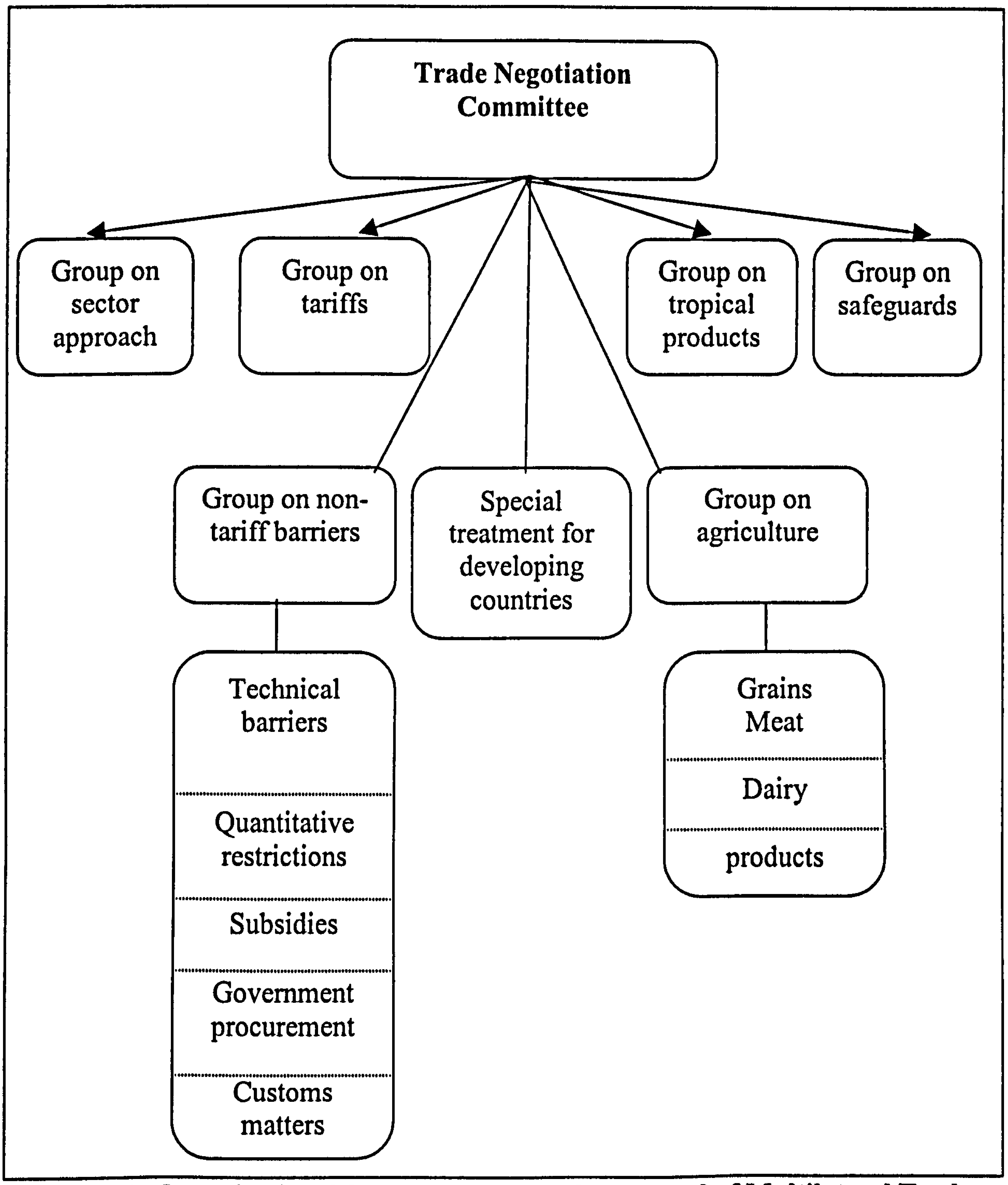


Figure 4.1: Organisational Structure of the Tokyo Round of Multilateral Trade Negotiations

Source: GATT (1980)

According to Croome (1995), nine MTN Agreements and Arrangements were negotiated in the Tokyo round (whose official name was the Multilateral Trade Negotiation "MTN"). A general assessment of the results of the MTN is that they did make some progress towards the achievements of some of the original objectives, but that they failed to contain the spread of protectionism, and despite all the 1973 rhetoric about the importance of securing special gains for developing countries, the upshot was that the negotiations were very largely among the rich countries. The developing countries took relatively little part in the main debates and most of their gains from the MTN were incidental. These points can be established by briefly examining the results in each of the main areas of negotiations.

4.4.3.1 Tariffs

According to GATT (1992), the question of tariff liberalisation proved to be relatively uncontroversial, largely because pre-Tokyo Round average tariffs on industrial goods was already low. As in table 4.3, pre-Tokyo Round averages were relatively low (by historical standards), although as is also obvious from the same table, tariff escalation is clearly evident. Furthermore, as in table 4.4, low overall averages concealed quite significant country differences.

Table 4.3: Tokyo Round Tariff Changes

		Tariff average		
		Pre-Tokyo	Post-Tokyo	Rate of reduction %
Total industrial products	W	7.2	4.9	33
	S	10.6	6.5	38
Raw materials	W	0.8	0.4	52
	S	2.6	1.7	36
Semi-manufactures	W	5.8	4.1	30
	S	9.7	6.2	63
Finished manufactures	W	10.3	6.9	33
	S	12.2	7.4	39

Notes: W= weighted (by MFN imports), S- simple average.

Source: GATT (1980)

Table 4.4: Tokyo Round Tariff Changes on Industrial Products: Country Breakdown

Country		Tariff averages		
		Pre-Tokyo	Post-Tokyo	Rate of reduction %
United States	W S	6.2 12.1	4.4 7.0	30 42
EEC	W S	6.6 8.1	4.8 5.6	27 31
Japan	W S	5.2 10.2	2.6 6.0	49 41
Canada	W S	12.7 12.4	7.9 7.2	38 42
Sweden	W S	5.2 5.9	4.3 4.8	23 19
Norway	W S	4.2 5.8	3.2 6.5	23 23
Switzerland	W S	3.2 3.8	2.5 2.8	23 26
New Zealand	W S	22.4 26.2	17.6 20.0	21 24
Austria	W S	9.0 11.6	7.8 8.1	13 30
Finland	W S	6.0 13.0	4.8 11.2	20 14

Source: Greenaway et al (1988)

To summarise, the total value of trade affected by the Tokyo Round negotiations on tariff reductions and tariff bindings (a commitment not to raise tariffs) came to more than 300 billion US dollars. As a result of these cuts, the weighted average tariff (that is, the average tariff measured against actual trade flows) on manufactured products in the world's nine major industrial markets fell from 7.0 percent to 4.7 percent. In addition, several industrialised participants agreed to eliminate all customs duties on civil aircraft, aircraft parts and repairs. These Zero duties were "bound" under the GATT.

4.4.3.2 Non-Tariff Measures

The Tokyo Round distinguished itself from previous Rounds by grappling with the problem of non-tariff barriers. The core of the Tokyo Round's achievement was to arrive at agreements or codes designed to reduce non-tariff measures and bring them under more effective international discipline. Not all Counteracting Parties subscribed to the codes. All the codes provide arrangements for consultation and dispute settlement (National Consumer Council, 1993).

According to GATT (1992), the non-tariff negotiation was a specific US objective, to control the spread of subsidies and other non-tariff practices that were impeding US trade. Agreements were reached on eight specific types of non-tariff measures. The best known of these is the code of subsidies and Countervailing Duties. These permit the imposition of countervailing duties on imports where there is evidence that they have benefited from a subsidy, provided that the subsidy is causing or threatening material injury to an established domestic industry. The amount of any countervailing duty is limited to an amount equal to the estimated value of the subsidy.

4.4.3.3 New Agreements on Agriculture

The Tokyo Round made some progress on agriculture, drawing up specific multilateral agreements on bovine meat and dairy products. The round also managed to reduce the import duties and other trade barriers on tropical products imposed by industrialised countries on developing countries.

Progress in the field of agriculture trade has always been difficult because of a combination of economic and political factors. This clash of interests has bedevilled attempts to liberalise trade in agriculture that has remained stringently controlled and protected while trade in manufacture has progressed to a stage of near free trade.

In the final analysis, slightly more progress was made in tariff cuts and bindings than that achieved during the Kennedy Round, but the gains to the US and other agricultural exporting nations were still very small.

4.4.3.4 A Better Deal for Developing Countries

A new clause established the legal basis on which developed countries could extend the generalised system of pretences to developing countries. A consultation procedure and a committee on trade and development had already been set up (in part four of the treaty) to follow all GATT activities and ensure that the problems of developing countries received priority. The committee's role was strengthened at the Tokyo Round by the creation of two new sub-committees, one to examine any new protective measures taken by developed countries against imports from developing countries, and the other to consider the trade problems of the least-developed countries.

4.4.3.5 Safeguards and Government Procurement

According to GATT (1986), endeavours to tackle the safeguard provisions in article 19, to bring grey area measures, such as voluntary export restraints, under GATT disciplines, were not successful. A committee was established within GATT to continue the safeguard negotiations but the issues left unresolved at Tokyo were carried through to the Uruguay Round.

Another significant agreement was on government procurement. Previously GATT provisions permitted governments to discriminate in their purchases in favour of domestic supplies. The aim of the new agreement was to promote greater international competition in supplying goods to governments and public agencies, but excluding certain key areas such as defence (EIU, 1995b). According to Croome (1995), although the Tokyo Round discussed this new area, it has some qualifications:

- The concessions of tariff reductions apply only to industrial countries' products. Agriculture products were treated differently, as in the Kennedy Round. Most countries operate some form of protectionism in agricultural markets, primarily for socio-political reasons.

- The concessions did not apply to all industrial goods. Sensitive items such as textiles, leather, footwear and travel goods were subject to zero or lower than average tariff reductions. Invariably these sensitive items were of interest to LDC manufacturing exporters.

General disappointment was expressed by many developing countries with the outcome of the Tokyo Round. The average tariff reduction on the exports from developing countries amounted to 25 percent according to GATT (1980). This takes account of the concessions made for tropical products, many of which gained duty-free entry. The tariff reductions agreed were to be implemented from 1 January 1980, and could be phased in over a period of eight years.

4.5 THE INSTITUTIONAL PROBLEMS OF GATT

Jackson (1990) argues that a number of institutional problems can be found in the GATT and was one of the reasons to call for a new round and a new system for international trade:

1. The fundamental treaty structure of the GATT is flawed on several counts. GATT rules did apply as binding international treaty obligations. The GATT also was a subject of some dispute between the Congress and the executive branch in the United States. Furthermore, grandfather rights still exist, even though they were originally intended to be temporary. A number of other institutional problems stem from this basic flaw in treaty structure, including the problem of amendments, the relationship to domestic law, the dispute settlement procedure, questions of membership, and problems of rule-making and power of the Contracting parties.

2. The amending provisions of the basic treaty structure are such that it is rarely considered possible to amend the GATT. The delay required by the treaty acceptance process, the difficulty of obtaining the required number of acceptance, the shift in bargaining power involved under the amending procedure in the context of a large membership, and the fact that even when an amendment

is effective in GATT it will not apply to countries which do not accept, are all reasons why the amending procedure has fallen into disuse. This has caused a certain rigidity and an inability to develop rules so as to accommodate the many new developments in international trade and other economic interdependence subjects. The World Bank (1995b) states that one result has been the development of an elaborate system of "side treaties" which create some of their own problems.

3. The relationship of the GATT treaty to domestic law in a number of GATT member countries is very unclear. Some problems may be unavoidable, since the national legal systems differ so widely. Nevertheless, some attention has been given to the possibility of introducing certain international treaty obligations with respect to how trade and economic rules should be implemented domestically; this is represented in the transparency principle.

4. Jackson (1990) states that a key problem is the relationship to GATT of these many side agreements, in most cases stand-alone treaties, which are intimately linked to the GATT treaty structure itself. It is unclear in some circumstances what this relationship is, and whether an obligation contained in the side agreement will prevail over that of the GATT or vice versa. In any event, since the side agreements tend to have a series of separate procedures for various matters including dispute settlement, there is a certain inefficiency in the potential "forum shopping".

5. According to Harrison et al (1997), the power of the Contracting Parties defined in the GATT agreement is very ambiguous. There are a number of unsettled and disquieting issues, such as the power of the Contracting Parties to interpret the GATT agreement; and the relationship of actions of the Contracting Parties with some of the side agreements, furthermore, the decision-making process leaves much to be desired. The so-called consensus approach has some inherent defects, but has evolved to ameliorate some of the problems of a one nation one-vote structure, coupled with the ambiguity and terseness of the GATT text. The GATT Council has been created by resolution of the contracting parties, and has no treaty status.

6. The dispute settlement processes of GATT have been among the more intriguing institutional evolutions. Dispute settlement procedures are intimately connected with problems of effectiveness. There is considerable concern about whether the GATT procedures can stand up to some of the pressures that are currently being imposed upon them.

7. Finally, the UNCTAD and the World Bank (1995) state that there has been a problem with respect to the relationship of GATT with other organisations such as, the International Monetary Fund (IMF) and the World Bank. This was one of the issues that have been discussed in the Uruguay Round.

4.6 REMAINING PROBLEMS IN TRADE LIBERALISATION

According to Williamson and Milner (1991), despite the great success in reducing tariffs through multilateral trade negotiations and reducing them in a non-discriminatory manner since World War II, many problems remain requiring future attention. These are the problems created by the existence of non-tariff trade barriers and agricultural protection, and resulting from the formation of regional trade associations.

1. Non-tariff barriers. Tariffs have been the dominant form of protection historically, but in recent decades, non-tariff barriers have been of steadily increasing importance. With tariff rates negotiated to very low levels, the non-tariff barriers have become relatively much more important. Even though a uniform international trade code of behaviour of non-tariff barriers was adopted as part of the Tokyo Round, this code is difficult to administer, leads to controversy over interpretation and application, and is far from being all-inclusive or complete. In the meantime, voluntary export restraints, escape clauses, trigger-price mechanisms, disguised export subsidies, international cartels and dumping, and many other non-tariff trade barriers remain and are proving extremely difficult to eliminate or even reduce.

2. Trade in agricultural goods. Hathaway and Ingco (1995) state that in all of the multilateral trade negotiations conducted since World War II, agriculture was always granted a special status and was generally exempted from tariff cuts. This is due primarily to the disproportionate power of agricultural interest in the internal affairs of most nations. In the US and the EEC, agricultural support programs result in huge surpluses of many products, especially milk and its derivatives, eggs, meat, and wheat. Not only has this prevented greater specialisation in these products by nations such as Australia and Canada, but as US and EEC surpluses are unloaded on the world market or given away as part of foreign aid, they "spoil" the export market of developing countries such as Argentina and Brazil.

3. The LDCs. Whalley (1995) states that GATT tariff reductions have centred on the manufacture exchanged among the industrial countries. Tariff reductions have also applied to LDC exports, because of the MFN clause, but the goods involved have not been of central importance to the LDCs such as textiles, that are in fact the most important for LDC development. A new part for improving LDC trade was added to the GATT in 1965, and during the 1970s the industrial countries adopted systems of tariff preferences for LDC manufacture. But benefits are modest. The retarded state of LDC is due in good part to the LDCs themselves, which have adopted protectionist policies and have refrained from aggressive participation in the GATT rounds. Demands for a new international order lose something in credibility when they come from those who are not fully exploiting the existing order. But the developing countries have indicated by their deeds that any substantial increase in LDC competition with DC manufacturing industries will meet protectionist resistance.

4. Trade in services. This includes tourism and transportation, insurance, telecommunication, banking, construction, and the income earned from foreign investment (the income is the fee paid for the services of the invested capital). Hoekman (1995) states that commodity trade has traditionally been regarded as much more important than service trade, but as pointed out before, service industries has grown rapidly for over a decade and is now prominent.

International trade in services has not been covered by international agreements, so national barriers abound. The US, as a large supplier of services, would like them to be brought into the GATT fold. Other industrial nations seem increasingly inclined to agree, but many developing counties and LDCs are reluctant. The US Trade and Tariff ACT of 1984 gave the president, for the first time, authority to negotiate international agreements to lower barriers to trade in services.

5. Counterfeit Goods. According to Braga (1995), automobile and aviation parts to drugs, fertilisers, and medical equipment. Pirated copies of books and computer software are readily produced in countries that do not subscribe to (or enforce) international copyright agreements. Trade in counterfeit goods has grown very rapidly in recent years. Producers of legitimate goods see both their sales and public images threatened by the counterfeiters. While the latter exist in most countries, a disproportionate share of counterfeit exports seems to come from industrialising countries. Taiwan is probably the largest single source. These countries have the ability to produce efficiently but not to innovate and have a comparative advantage in counterfeiting.

6. Regional economic arrangements, such as the EEC, which eliminate tariffs among members but retain them against the rest of the world, are clearly against the GATT principle of non-discrimination. They are also against the economic interests of outsiders. Parker (1998) states that aside from possible political benefits, regional economic associations can only be justified on purely economic grounds from the welfare point of view if they represent a step toward or facilitate lower all-round trade barriers.

As we have seen, the Tokyo Round addressed the first three of these outstanding issues, but achieved significant progress only with respect to non-tariff barriers. The international community called for a new GATT negotiation round; it is already referred to as the Uruguay Round, since a preliminary ministerial meeting was held in that country. Progress on the other four issues was a major goal of this round.

4.7 URUGUAY ROUND

4.7.1 TOWARDS A NEW ROUND

According to Jackson (1990), since the completion of the Tokyo Round in 1979, it was obvious to most trade policy members that a new round would be necessary. Partly this is because of the "bicycle theory" of trade policy, namely that unless there is forward movement, the bicycle will fall over. If there were no initiatives on trade policy, the temptations of national governments to backslide would be great. But in addition, the world was becoming increasingly complex and interdependent, and it was becoming more and more obvious that the GATT rules were not satisfactorily providing the measure of discipline needed to prevent tensions and damaging national activity. Very significant and substantial new subjects were proposed for GATT competence (including services and intellectual property) and these would require a prolonged period of consultation, diplomacy and negotiation (Hufbauer and Schott, 1996).

The period between the end of the Tokyo Round and the beginning of the Uruguay Round lasted seven years; a longer gap between rounds than had ever been experienced before. Those seven years saw the world hit by a second oil price shock and the onset of a worldwide recession. According to the World Bank (1995a), as 1980 approached, the international economic situation deteriorated further, with widespread inflation and unemployment, monetary instability, and large payments imbalances. Increasingly, oil-importing countries in particular found themselves unable to handle the debts they had run up to finance their sharply increased fuel costs. Over the year as a whole, trade growth slowed to barely 1% in volume. The worst was still to come. Bergsten (1996b) states that the years 1981 and 1982 were to be even more difficult for the world economy, for world trade, and for international economic relations. However, they were also to see the first concerted efforts by the trading nations to restore purpose and direction to their joint efforts in GATT. Although the launching of new multilateral negotiations was still more than half a decade away, the Uruguay Round's conception, and much of its agenda, stems from events and discussions in 1981 and 1982.

4.7.2 LAUNCHING THE URUGUAY ROUND

According to Croome (1995), exactly six years after the depression of 1980, on 28 November 1986, GATT member governments took the key decision to start preparations for a new and even more ambitious round of multilateral trade negotiations. The Uruguay Round of negotiations in the GATT took over four years to prepare, and eight more years to complete. Failure often threatened; success was not certain until the very last days. The most ambitious worldwide negotiations ever attempted on trade matters-perhaps, indeed, on any economic subject-the Round covered an enormous range of questions, many highly sensitive. Over one hundred governments took part, defending the interests of countries of all sizes, stages of development and economic structures.

OECD (1996a) states that unlike previous GATT negotiations, this one spilled over into the political arena, sparking sharp controversy, international tension, and in some countries even riots. The agreements reached were expected to influence world growth and development for decades to come. According to WTO (1995b), the Uruguay Round proceeded under four fundamental principles:

- The agreement would be a single undertaking so as to prevent the formation of a GATT-plus or super-GATT of like-minded developed countries.

- There would be parallelism in an effort to avoid cross-sectoral demands. Developing countries were concerned that the USA might dangle the offer of tariff reductions on textiles in return for concessions from them on services.

- The negotiations would recognise the principle of non-reciprocity on the part of the developing countries-in other words poorer countries would have to open their markets somewhat less.

- The negotiations would be conducted openly. Fourteen negotiating groups were set up to discuss issues on trade in goods and one was set up to negotiate on services. Within these groups there were four mandates: market access, rule-making, institutional reform and new issues.

According to the EIU (1995b), during the negotiations, countries were expected to apply the principle contained in the standstill and rollback framework. Under standstill, countries were not to take any protectionist measures in an effort to improving their negotiating position and were to apply GATT rules in their trade relations. Under rollback, countries were expected to phase out any current GATT-inconsistent measures by the end of the negotiations.

A brief explanation of the structure of Uruguay Round history may be helpful. According to EIU (1995b), the Round divides into five fairly distinct time periods, separated by three ministerial meetings (Punta del Este in 1986, Montreal in 1988 and Brussels in 1990), and by the presentation of the first comprehensive but tentative package of results in 1991.

4.7.2.1 Punta del Este Declaration (1986)

According to GATT (1994), on 14 September 1986, the ministerial meeting opened in Punta del Este. The declaration of Punta del Este contains the mandate of this new round, and it is very broad indeed. The declaration was deemed a considerable success for the US and a number of other countries who had been supporting abroad mandate. One of the key questions- whether services would be negotiated-was largely answered in the affirmative, though not without some compromise.

According to Croome (1995), the structure of the Punta del Este declaration makes it clear that the question of whether services would ultimately be part of the GATT structure (or that of some other organisation) was left open by the declaration. Thus it is that the structure of the negotiation on the one hand deals with trade in goods, while setting up a separate committee and negotiating structure for trade in services.

Nevertheless, as time goes by, it is the opinion of many official and diplomats that the idea of the GATT system having competence over trade in services seems to be more widely accepted. Thus a separate agreement on services is very likely, along with a number of specific service sector agreements or chapters.

4.7.2.2 Montreal Meeting (1988)

According to the GATT (1994), after Punta del Este, the Contracting Parties established 14 negotiating groups to work on the problems of trade in goods and a separate structure was set up for negotiations on trade in services. An elaborate meeting schedule was formulated, and governments were geared up to handle these meetings.

It was soon decided that there was would be a mid-term review towards the end of 1988, which would be a meeting of GATT Contracting Party Ministers of Trade, to survey progress and establish directions for the remainder of the negotiation. Originally it was thought that some concrete agreements might be implemented, with the possible exception of improvement in the dispute settlement process. Rather the agreements set forth the framework of the further negotiations.

According to the GATT (1992), the mid-term review was held in December 1988 in Montreal on the basis of draft texts prepared by each of the negotiating committees. Some of these were very elaborate; others were rather short. Some of the texts were heavily laden with ' square brackets' of alternative provisions.

According to Croome (1995), at the end of the Montreal meeting it was announced that agreement had not been reached. Certain texts had been accepted, but some countries were not prepared to accept those unless all other texts were also accepted, and there was considerable controversy over certain key issues, including agriculture. Consequently, it was decided that the GATT Director-General would try to get the various Contracting parties to establish agreement on a final text, and this occurred after some meetings in Geneva in April 1989.

It is not surprising that there was a lack of agreement at Montreal. According to EIU (1996), the two largest trading blocs (USA and EU) were represented at that meeting by officials who were leaving their positions. In the US, the November 1988 presidential election had established that the Bush Administration would succeed the Reagan Administration, but Reagan officials were still in charge at Montreal, and it was not always clear who their successors would be. Likewise and coincidentally, in the European Economic Community, Frans Andriessen was about to replace Willy De Clercq as commissioner for external Relations (the counterpart of the US trade negotiator). As it turned out in the US the trade representative, Clayton Yeutter, became Secretary of agriculture and in the EC, the Commissioner for Agriculture, Frans Andriessen, became trade negotiator.

However the other side effect was to create an element of paralysis, or inability to make the necessary compromises in order to achieve an agreement at Montreal. Nevertheless, once the new administrations were in place, and since their positions were relatively un-compromised by their predecessors, they were able to move forward and achieve some sort of consensus. The result of this process, by the end of April 1989, was the set of agreements of the mid-term review.

Despite the difficulties of the Montreal Meeting, ministers agreed a package of early results which included some concessions on market access for tropical products aimed at assisting developing countries as well as a streamlined dispute settlement system, and the Trade Policy Review Mechanism which provided for the first comprehensive, systematic and regular reviews of national trade policies and practices of GATT members.

4.7.2.3 Brussels (1990)

According to the original Uruguay Round timetable, the deadline for the Round was set for December 1990. However, four major issues were still outstanding: agriculture, safeguard, textiles and TRIPs. According to the WTO (1995b), Arthure Dunkel, then GATT director-general, set up seven negotiating groups to cover market access, agriculture, GATT rule-making, textiles and clothing, institutional questions, services and TRIPs. Informal meetings continued, in the hope that a few more days, and the pressure of the Brussels deadline, might push delegates into working out agreements that had previously eluded them. In green room meetings with the heads of key delegations interested in each subject, Dunkel confronted them with central issues and choices. He recruited individual senior representatives to explore with their colleagues options and possibilities of movement on particular subjects, and to put forward their own proposals. Some progress was achieved, but not much. Governments were clearly not yet ready to take the key decision on the most sensitive subjects, and until these decisions were made they would not risk weakening their bargaining position by making concessions even on less-controversial matters.

Croome (1995) states that agreed texts, partially-agreed texts, and explanations of why no agreements had been reached were brought together in a single working document of the Trade Negotiations Committee (TNC). This "first approximation to the Final Act embodying the results of the Uruguay Round of Multilateral Trade negotiations", as it was described by its cover note, soon grew to massive proportions. Even in the absence of any texts on anti-dumping or TRIMPS, and with no agreement on agriculture, it ran to nearly 400 pages. Moreover, very many of those pages were liberally scattered with the square brackets denoting disputed language: some brackets embraced a succession of brief alternative formulations, while others marked off long passages which had been endorsed by some governments but rejected by others. Most texts were preceded by a commentary describing the main issues still open. Blackhurst et al (1995) state that far from constituting the "final and complete package" which NTC members had agreed in July should be ready by 23 November. This Draft Final Act, issued on 3 December-opening day of the Brussels meeting-impressed most readers more by the huge range of matters still unsettled than by the few completed agreements it recorded. A new introductory text-the proposed Final Act itself-carried no more conviction, and received little attention. The product of informal meetings in the last weeks, this text dealt with issues of great importance: the relation of the Uruguay Round texts to one another; whether acceptance of any would require acceptance of all; the desirability of a new multilateral trade organisation or (less ambitious alternative) a new organisational structure, and whether its coverage would extend beyond trade in goods; and the obligations of least-developed countries. But none of these matters had been settled.

A final pre-Brussels meeting of the TNC in Geneva on 26 November did nothing to raise expectations. Delegates of one country after another recorded their disappointment with the results that had emerged from the negotiating groups.

4.8 FINAL ACT OF THE URUGUAY ROUND

According to WTO (1995a), the Final Act embodying the results of the Uruguay Round of Multilateral Trade Negotiations was signed by ministers in Marrakesh on 15 April 1994. It covers all the results from the Uruguay Round. Many Agreements have since been reached.

4.8.1 AGREEMENT ESTABLISHING THE WORLD TRADE ORGANISATION (WTO)

According to GATT (1994), the agreement establishing the World Trade Organisation (WTO) calls for a single institutional framework encompassing the GATT, as modified by the Uruguay Round. Its structure is headed by a Ministerial Conference meeting at least once every two years. A General Council oversees the operation of the agreement and ministerial decisions on a regular basis. This General Council acts as a Dispute Settlement Body and a Trade Policy Review Mechanism, which concern themselves with the full range of trade issues covered by the WTO, and it has also established subsidiary bodies such as a Goods Council, a Services Council and a TRIPs Council. The WTO framework ensures a "single undertaking approach" to the results of the Uruguay Round - thus, membership of the WTO entails accepting all the results of the Round without exception.

4.8.2 GENERAL AGREEMENT ON TARIFFS AND TRADE 1994 (GATT 1994)

GATT 1994 is an updated version of GATT 1947. Each WTO member is required to treat products imported from different partners on the same basis (the Most-Favoured-Nation principal MFN). Other central requirements include the National Treatment of imported products (Article III), so that once imported products are inside the border, they face the same conditions of competition as domestically-produced products, freedom of transit for merchandise trade (Article V), and a prohibition on quantitative restrictions (Article XI).

According to the EC (1998c), exceptions to these obligations may be invoked under certain conditions and tariff bindings may be renegotiated with compensation. Thus, the WTO rules, like the GATT, do not preclude the possibility of governments granting assistance to a sector, but guide the choice of policy instrument in the interest of maintaining an open trading system.

4.8.3 AGRICULTURE

According to the World Bank (1995b), the preamble to the agreement on agriculture noted the need to apply GATT rules and disciplines to the agricultural sector, and the need to liberalise the sector in three areas:

- Market access;
- Domestic support;
- Export competition.

Special dispensation was requested for developing countries that either export tropical products or other agricultural products. The need to ensure food security and the protection of the environment is also mentioned in the agreement. Special peace provisions are built into the agreement, placing an obligation lasting nine years on actions taken in three areas:

- No questioning of green box policies under the subsides agreement;
- No countervailing duties to be used in the area of agriculture;
- A limit on the degree to which a country can claim nullification or impairment of its rights under the agreement.

Overall, the results of the negotiations provided a framework for the long-term reform of agricultural trade and domestic policies over the years to come. It made a decisive move towards the objective of increased market orientation in agricultural trade. The rules governing agricultural trade were strengthened which in order to improve predictability and stability for importing and exporting countries alike.

According to Goldin and Mensbrugghe (1995), the agricultural package also addressed many other issues of vital economic and political importance to many members. These included provisions that encouraged the use of less trade-distorting domestic support policies to maintain the rural economy, that allowed actions to be taken to ease any adjustment burden, and also the introduction of tightly prescribed provisions that allowed some flexibility in the implementation of commitments. Specific concerns of developing countries were addressed, including the concerns of net-food importing countries and least-developed countries.

4.8.4 AGREEMENT ON TRADE IN SERVICES (GATS)

According to EC (1999b), The General Agreement on Trade in Services (GATS) defined trade in services in four ways:

- The supply of a service from one country to another (such as banking services);
- The supply of a services in the territory of one country to a consumer from another (such as tourism);
- The commercial presence of a foreign company in a host country;
- The supply of labours (legally defined nationals of a country) by a service supplier for work in a foreign country.

The service agreement covers all levels of national jurisdiction from central to local government, but does not cover non-commercial services supplied in the exercise of governmental authority. Negotiations over openness in government procurement were left to particular agreement negotiated between a smaller group of members.

4.8.5 AGREEMENT ON TEXTILES AND CLOTHING

According to the WTO (1995a), the object of this negotiation was to secure the eventual integration of the textiles and clothing sector - where much of the trade was subject to bilateral quotas negotiated under the Multi-fibre Arrangement (MFA) - into the GATT on the basis of strengthened GATT rules and disciplines.

Integration of the sector into the GATT took place as follows: first, on 1 January 1995; each party integrated into the GATT products from the specific list in the Agreement which accounted for not less than 16 percent of its total volume of imports in 1990. Integration meant that trade in these products was to be governed by the general rules of GATT.

Second, the Multi-Fiber Arrangement (MFA) was to be incorporated into the GATT over a ten-year period beginning in 1995. This incorporation did not mean the removal of all barriers to textile trade; it meant the application of GATT principles to those barriers. The textiles deal involved a hybrid of the approaches described above, with the imposition of indirect global quotas and the growing out of the MFA over time.

Finally, Article 1 of the Agreement set out the general principles regarding special treatment for countries previously outside the MFA system and those countries that are cotton exporters. Each member of the World Trade Organisation (WTO) had to inform the WTO of any measures to be brought in under the GATT with regard to the NFA within 60 days of the agreement coming into force. The notifactory body was called the Textiles Monitoring body (TMB). Any unilateral measures taken under the MFA signed before the GATT 1994 came into force was to be notified to the Textiles Surveillance Body.

4.8.6 AGREEMENT ON TRADE-RELATED INVESTMENT MEASURES (TRIM)

According to the WTO (1995a), the agreement recognised that certain investment measures restricted and distorted trade. It was drafted so that no contracting party could 1 apply any TRIM inconsistent with Articles III (national treatment) and XI (prohibition of quantitative restrictions) of the GATT. To this end, an illustrative list of TRIMs agreed to be inconsistent with these articles was appended to the agreement. The list included measures that required particular levels of local procurement by an enterprise ("local content requirements") or which restricted the volume or value of imports such an enterprise can purchase or use to an amount related to the level of products it exported ("trade balancing requirements").

The agreement required mandatory notification of all non-conforming TRIMs and their elimination within two years for developed countries, within five years for developing countries and within seven years for least-developed countries. It established a Committee on TRIMs, which could, among other things, monitor the implementation of these commitments. The agreement also provided for consideration, at a later date, of whether it should be complemented with provisions on investment and competition policy more broadly.

4.8.7 AGREEMENT ON TRADE RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS (TRAIPS), INCLUDING TRADE IN COUNTERFEIT GOODS

According to Braga (1995), the agreement recognised that widely varying standards in the protection and enforcement of intellectual property rights and the lack of a multilateral framework of principles, rules and disciplines dealing with international trade in counterfeit goods had been a growing source of tension in international economic relations. Rules and disciplines were needed to cope with these tensions. To that end, the agreement addressed the applicability of basic GATT principles and those of relevant international intellectual property agreements; the provision of adequate intellectual property rights; the provision of effective enforcement measures for those rights; multilateral dispute settlement; and transitional arrangements.

4.8.8 AGREEMENT ON SUBSIDIES AND COUNTERVAILING DUTIES

The Agreement on Subsidies and Countervailing Measures was intended to build on the Agreement on Interpretation and Application of Articles VI, XVI and XXIII, which was negotiated in the Tokyo Round.

Unlike its predecessor, the agreement contained a definition of subsidy and introduced the concept of a "specific" subsidy - for the most part, a subsidy available only to an enterprise or industry or group of enterprises or industries within the jurisdiction of the authority granting the subsidy. Only specific subsidies would be subject to the disciplines set out in the agreement.

For the purpose of the agreement, which applied only to non-farm goods, a subsidy could represent one of the following:

- A direct transfer of funds from the government, or the potential transfer of funds or liabilities (e.g. loan guarantees);
- Forgone revenue such as tax credits;
- Government provision of goods or purchase guarantees;
- Government payments to an intermediate body, which makes payments in, line with the previous three categories.

4.8.9 AGREEMENT ON TECHNICAL BARRIERS TO TRADE

This agreement extended and clarified the Agreement on Technical Barriers to Trade reached in the Tokyo Round. It sought to ensure that technical negotiations and standards, as well as testing and certification procedures, did not create unnecessary obstacles to trade. However, it recognised that countries have the right to establish protection, at levels they consider appropriate, for example, for human, animal or plant life or health or the environment, and should not be prevented from taking measures necessary to ensure those levels of protection are met. The agreement therefore encouraged countries to use international standards where these are appropriate, but it did not require them to change their levels of protection as a result of standardisation.

4.8.10 AGREEMENT ON SANITARY AND PHYTOSANITARY MEASURES

The agreement on sanitary and phytosanitary measures is a sister agreement to the one on technical barriers to trade in general. However, under this agreement, the technical barriers to trade concerned food, plant and animal health and safety. According to the WTO (1995b), Sanitary and Phytosanitary measures were defined as any one of the following measures:

- To protect animal or plant life or health within the territory of a member, or to halt disease and pests;
- To protect human or animal life or health from risks arising from toxins, disease carrying organism in food, beverages and foodstuffs, and additives;
- To protect animal or human life from the spread of animal- or plant transported diseases.

This is a "touchy" area for international rule making. Sanitary and phytosanitary rules are applied to protect, in abroad since, the consumers and environment of a country. As such each country according to its own environmental and consumer awareness has developed these rules, and often under pressure from domestic environmental groups, which fear that, this application of international standards could be used to dilute domestic environmental protection.

4.8.11 DISPUTES SETTLEMENT

The dispute settlement system of the GATT is generally considered to be one of the cornerstones of the multilateral trade order. The system has already been strengthened and streamlined as a result of reforms agreed following the Mid-Term Review Ministerial Meeting held in Montreal in December 1988. Disputes currently being dealt with by the Council are subject to these new rules, which include greater automation in decisions on the establishment, terms of reference and composition of panels, such that these decisions are no longer dependent upon the consent of the parties to a dispute. The Uruguay Round Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) further strengthened the existing system significantly, extending the greater automation agreed in the Mid-Term Review to the adoption of the panels' and a new Appellate Body's findings. Moreover, the DSU established an integrated system permitting WTO members to base their claims on any of the multilateral trade agreements included in the Annexes to the Agreement establishing the WTO. For this purpose, a Dispute Settlement Body (DSB) exercises the authority of the General Council and the Councils and committees of the covered agreements.

4.8.12 AGREEMENT ON ANTI- DUMPING

Article II of the anti-dumping agreement of the GATT 1994 defines dumping as occurring when a product is introduced into the commerce of another country at less than its normal value.

WTO (1995a) stated that the agreement strengthened the requirement for the importing country to establish a clear causal relationship between dumped imports and injury to the domestic industry. The examination of the dumped imports on the industry concerned must include an evaluation of all relevant economic factors bearing on the state of the industry concerned. The agreement confirms the existing interpretation of the term "domestic industry". Subject to a few exceptions, "domestic industry" referred to the domestic producers as a whole of the like products or to those whose collective output of the products constitutes a major proportion of the total domestic production of those products.

Clear-cut procedures have been established on how anti-dumping cases are to be initiated and how such investigations are to be conducted. Conditions for ensuring that all interested parties are given an opportunity to present evidence are set out. Provisions on the application of provisional measures, the use of price undertakings in anti-dumping cases, and on the duration of anti-dumping measures have been strengthened. Thus, a significant improvement over the existing Agreement consists of the addition of a new provision under which anti-dumping measures shall expire five years after the date of imposition, unless a determination is made that, in the event of termination of the measures, dumping and injury would be likely to continue or recur.

The agreement calls for prompt and detailed notification of all preliminary or final anti-dumping actions to a Committee on Anti-Dumping Practices. The agreement affords parties the opportunity of consulting on any matter relating to the operation of the agreement or the furtherance of its objectives, and to request the establishment of panels to examine disputes.

4.8.13 AGREEMENT ON IMPLEMENTATION OF ARTICLE VII (CUSTOMS VALUATION)

According to EIU (1995b), the Decision on Customs Valuation gives customs administrations the right to request further information of importers where they have reason to doubt the accuracy of the declared value of imported goods. If the administration maintains a reasonable doubt, despite any additional information, it may be deemed that the customs value of the imported goods cannot be determined on the basis of the declared value, and customs would need to establish the value taking into account the provisions of the Agreement. In addition, two accompanying texts further clarify certain of the Agreement's provisions relevant to developing countries and relating to minimum values and importations by sole agents, sole distributors and sole concessionaires.

4.8.14 AGREEMENT ON RULES OF ORIGIN

The agreement aimed at the long-term harmonisation of rules of origin, other than rules of origin relating to the granting of tariff preferences, and to ensure that such rules did not themselves create unnecessary obstacles to trade.

WTO (1995a) stated that the agreement sets up a harmonisation programme based upon a set of principles, including making rules of origin objective, understandable and predictable.

Under the agreement of rules of origins, the contracting parties were expected to ensure that their rules of origin were transparent; that they did not have restricting, distorting or disruptive effects on international trade; that they were administered in a consistent, uniform, impartial and reasonable manner, and that they were based on a positive standard (in other words, they should state what confers origin rather than what does not).

An annex to the agreement sets out a common declaration with respect to the operation of rules of origin on goods, which qualify for preferential treatment.

4.8.15 AGREEMENT ON IMPORT LICENSING PROCEDURES

The revised agreement strengthened the discipline on the users of import licensing systems - which, in any event, are much less widely used now than in the past - and increases transparency and predictability. For example, the agreement requires parties to publish sufficient information for traders to know the basis on which licences are granted. It contains strengthened rules for the notification of the institution of import licensing procedures or changes therein. It also offers guidance on the assessment of applications.

4.8.16 AGREEMENT ON SAFEGUARDS

Article XIX of the General Agreement allows a GATT member to take a safeguard action to protect a specific domestic industry from an unforeseen increase of imports of any product which is causing, or which is likely to cause, serious injury to the industry.

Finger (1995) suggested that the agreement broke major ground in establishing a prohibition against so-called grey area measures, and in setting a sunset clause on all safeguard actions. The agreement stipulated that a member should not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side. Any such measure in effect at the time of entry into force of the agreement would be brought into conformity with this agreement, or would have to be phased out within four years after the entry into force of the agreement establishing the WTO. An exception could be made for one specific measure for each importing member, subject to mutual agreement with the directly concerned member, where the phase-out date was set at 31 December 1999.

All existing safeguard measures taken under Article XIX of the General Agreement 1947 were to be terminated not later than eight years after the date on which they were first applied or five years after the date of entry into force of the agreement establishing the WTO, whichever comes later.

4.8.17 AGREEMENT ON PRE-SHIPMENT INSPECTION

According to EIU (1995b), Pre-shipment inspection (PSI) is the practice of employing specialised private companies to check shipment details - essentially price, quantity, quality - of goods ordered overseas. Used by governments of developing countries, the purpose is to safeguard national financial interests (prevention of capital flight and commercial fraud as well as customs duty evasion, for instance) and to compensate for inadequacies in administrative infrastructures.

The agreement recognised that GATT principles and obligations applied to the activities of pre-shipment inspection agencies mandated by governments. The obligations placed on PSI-user governments include non-discrimination, transparency, protection of confidential business information, avoidance of unreasonable delay, the use of specific guidelines for conducting price verification and the avoidance of conflicts of interest by the PSI agencies.

4.8.18 GOVERNMENT PROCUREMENT

According to WTO (1999j), the Government Procurement Agreement, which is designed to facilitate the membership of developing countries, envisages consultation between existing members and applicant governments which would be followed by the establishment of accession working parties to examine the offers made by applicant countries (in other words, the public entities whose procurement will be opened up to international competition) as well as the export opportunities for the applicant country in the markets of existing signatories. This agreement should be distinguished from the new Agreement on Government Procurement.

4.9 WORLD TRADE ORGANISATION (WTO), THE MULTILATERAL TRADING SYSTEM

According to GATT (1994), a major outcome of the Uruguay Round has been the establishment of the World Trade Organisation (WTO), the only international body dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and singed by the bulk of the world's trading nations. It came into force on 1 January 1995.

Its main functions, as defined in article III of the Agreement, were to facilitate the implementation, administration and operation of the Uruguay Round Agreements, and to provide a forum for negotiations among members. The WTO's overriding objective being to help trade flow smoothly, freely, fairly and predictably. It was intended to achieve this by:

- Administering trade agreements;
- Acting as a forum for trade negotiations;
- Settling trade policies;
- Assisting developing countries in trade policy issues, through technical assistance and training programmes;
- Co-operation with other international organisations.

According to the WTO (1995b), in 1999, the WTO had 135 members, accounting for over 90% of world trade. Over 30 others are negotiating membership. Decisions are made by the entire membership, typically by consensus. A majority vote is also possible but it has never been used in the WTO, and was extremely rare under the WTO's predecessor, GATT. The WTO agreements have been ratified in all members' parliaments.

4.10 WORLD TRADE ORGANISATION (WTO) STRUCTURE

The WTO is an organisational structure open to all countries. It consists of a Ministerial conference, top-level decision-making body, meeting at least once every two years. Below this is the General Council (normally ambassadors and heads of delegation at Geneva, but sometimes officials sent from members' capitals) which meets several times a year in the Geneva headquarters. The General Council also meets as the Trade Policy Review Body and the Dispute settlement body. At the next level, the Goods Council, Service Council and Intellectual property (TRIPS) Council report to the General Council (see figure 4.2). Numerous specialised committees, working groups and working parties deal with individual agreements and other areas, such as the environment, development, membership applications and regional trade agreements.

The first Ministerial Conference in Singapore in 1996 added three new working groups to this structure to deal with the relationship between trade and investment, trade and competition policy and transparency in government procurement. At the second Ministerial Conference in Geneva in 1998, ministers decided that the WTO would also study the area of electronic commerce, a task to be shard among existing councils and committees. The last Ministerial Conference took place in Seattle in 2000, but failed to approve any new decisions. This was due to the conflict between the EC and the USA.

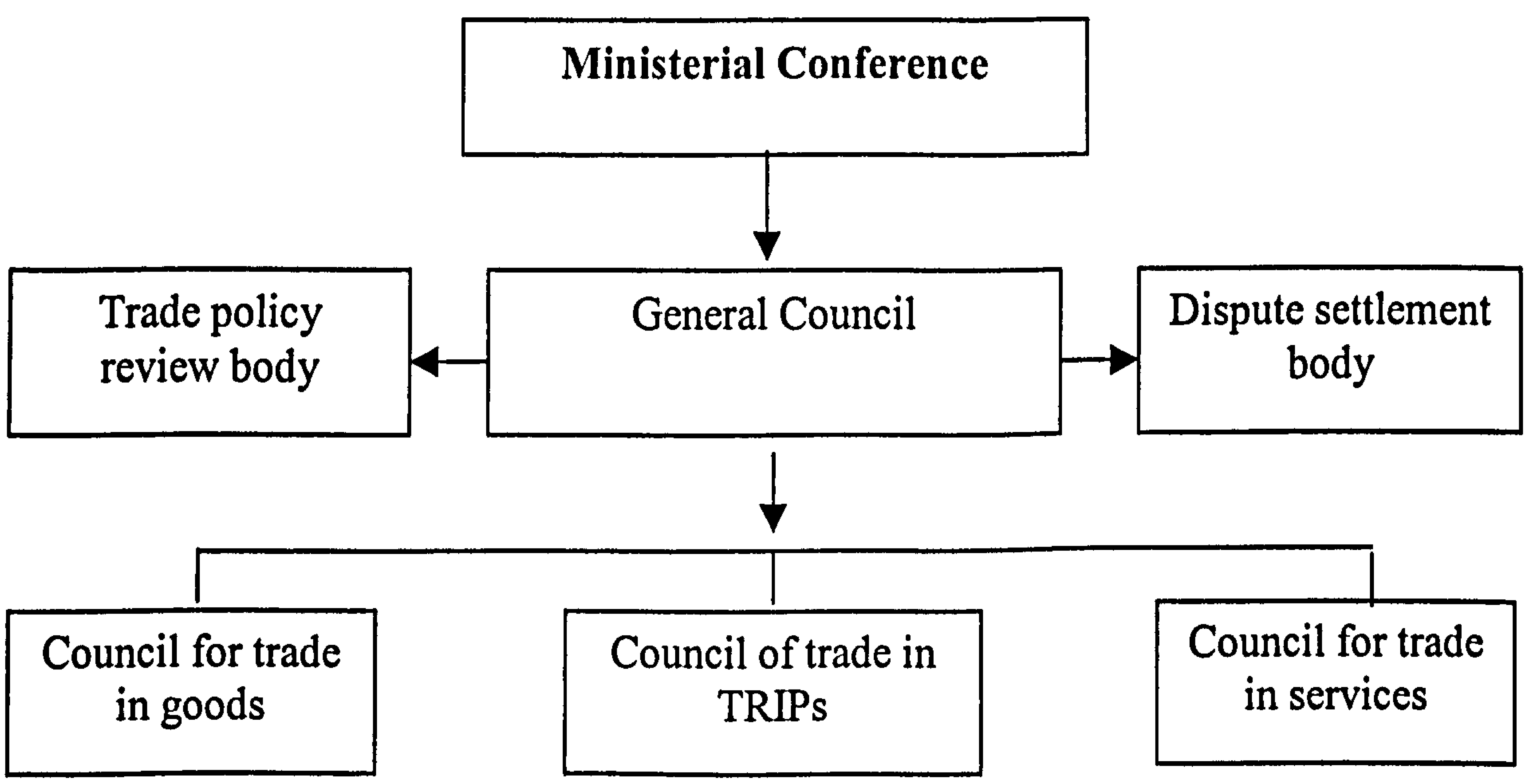


Figure 4.2: World Trade Organisation Structure
Source: WTO (1995b)

4.10.1 PRINCIPLES OF THE TRADING SYSTEM

The WTO agreements are lengthy and complex because they are legal texts covering a wide range of activities WTO (1996a). They deal with agriculture, textiles and clothing, banking, telecommunications, government purchases, industrial standards, food sanitation regulations, intellectual property, and much more. But a number of simple, fundamental principles run throughout all of these documents, which are the foundation of the multilateral trading system.

4.10.1.1 Trade without Discrimination

In common with the GATT (1947), non-discrimination is the key principle of the WTO. Under the WTO agreements countries cannot normally discriminate between their trading partners (MFN principle) and between foreign and the domestic producers (National Treatment principle).

Some exemptions to the MFN are allowed. For example, countries within a region can set up a free trade agreement that does not apply to goods from outside the group. Or a country can raise barriers against products from specific countries that are considered to be traded unfairly. And in services, countries are allowed, in limited circumstances, to discriminate. But the agreements only permit these exceptions under strict conditions.

4.10.1.2 Freer Trade: Gradually, Through Negotiation

Lowering trade barriers is one of the most obvious means of encouraging trade. According to Mikic (1998), opening markets can be beneficial, but requires adjustment. The WTO agreements allow countries to introduce changes gradually, through progressive liberalisation. Developing countries are usually given longer to fulfil their obligations.

4.10.1.3 Predictability

Sometimes, a declaration that trade barriers will not be increased can be as important as lowering them because the declaration removes uncertainty and gives businesses a clearer view of their future opportunities. With stability and predictability, investment is encouraged, jobs are created and consumers can fully enjoy the benefits of competition - choice and lower prices. The multilateral trading system is an attempt by governments to make the business environment stable and predictable.

According to the EIU (1996), the system tries to improve predictability and stability in different ways. One way is to discourage the use of quotas and other measures used to set limits on quantities of imports - administering quotas can lead to more red-tape and accusations of unfair play. Another is to make countries' trade rules as clear and public ("transparent") as possible. Many WTO agreements require governments to disclose their policies and practices publicly within the country or by notifying the WTO. The regular surveillance of national trade policies through the Trade Policy Review Mechanism provides a further means of encouraging transparency both domestically and at the multilateral level.

4.10.1.4 Promoting Fair Competition

The WTO is sometimes described as a "free trade" institution, but that is not accurate as the system allows tariffs and, in limited circumstances, other forms of protection. More accurately, it is a system of rules dedicated to open, fair and undistorted competition.

The rules on non-discrimination (MFN) and National Treatment are designed to secure fair conditions of trade. So too are those on dumping (exporting at below cost to gain market share) and subsidies. The issues are complex, and the rules try to establish what is fair or unfair, and how governments can respond, in particular by charging additional import duties calculated to compensate for damage caused by unfair trade.

Croome (1995) states that many of the other WTO agreements aim to support fair competition: in agriculture, intellectual property and services, for example.

4.10.1.5 More Beneficial for Less Developing Countries

It is widely recognised by economists and trade experts that the WTO system contributes to development. It is also recognised that the least-developed countries need flexibility in the time they take to implement the agreements. And the agreements themselves inherit the earlier provisions of GATT that allow for special assistance and trade concessions for developing countries.

According to Whalley (1995), over three-quarters of WTO members are developing countries and countries in transition to market economies. During the seven and a half years of the Uruguay Round, over 60 of these countries implemented trade liberalisation programmes autonomously. At the same time, developing countries and transition economies were much more active and influential in the Uruguay Round negotiations than in any previous round. This trend effectively killed the notion that the trading system existed only for industrialised countries. It also changed the previous emphasis on exempting developing countries from certain GATT provisions and agreements.

At the end of the Uruguay Round, developing countries were prepared to take on most of the obligations required of developed countries. But the agreements gave them transition periods to adjust to the more unfamiliar and, perhaps, difficult WTO provisions - particularly for the poorest, least-developed countries.

4.11 WORLD TRADE ORGANISATION MEMBERSHIP

According to GATT (1994), all members have joined the system as a result of negotiation and therefore membership means a balance of rights and obligations. They enjoy the privileges that other member-countries give to them and the security that the trading rules provide. In return, they had to make commitments to open their markets and to abide by the rules - those commitments were the result of the membership (or accession) negotiations.

For most WTO members, the negotiations took place under the old GATT system. Most automatically became founder members of the WTO on 1 January 1995 because they had signed the Uruguay Round agreement in Marrakesh in April 1994. Some joined GATT after April 1994 but before the WTO was set up and they also joined the WTO automatically. Another small group had participated in the Uruguay

Round but did not complete their membership negotiations until 1995, when they, too, joined. All of these countries are considered "original" WTO members.

4.11.1 THE ACCESSION PROCESS OF WTO MEMBERSHIP

Any state or customs territory having full autonomy in the conduct of its trade policies may join (accede to) the WTO, but WTO members must agree to the terms of membership and the application goes through four stages:

First, "tell us about yourself". The government applying for membership has to describe all aspects of its trade and economic policies that have a bearing on WTO agreements. This is submitted to the WTO in a memorandum, which is examined by the working party dealing with the country's application. These working parties are open to all WTO members.

Second, "work out with us individually what you have to offer". When the working party has made sufficient progress on principles and policies, parallel bilateral talks begin between the prospective new member and individual countries. They are bilateral because different countries have different trading interests. These talks cover tariff rates and specific market access commitments, and other policies in goods and services. The new member's commitments are to apply equally to all WTO members under normal non-discrimination rules, even though they are negotiated bilaterally. In other words, the talks determine the benefits (in the form of export opportunities and guarantees) other WTO members can expect when the new member joins. (The talks can be highly complicated. It has been said that in some cases the negotiations are almost as large as an entire round of multilateral trade negotiations).

Third, "let's draft membership terms". Once the working party has completed its examination of the applicant's trade regime, and the parallel bilateral market access negotiations are complete, the working party finalises the terms of accession. These appear in a report, a draft membership treaty "protocol of accession", and lists "schedules" of the member-to-be his commitments.

Finally, "the decision". The final package, consisting of the report, protocol and lists of commitments, is presented to the WTO General Council or the Ministerial Conference. If a two-thirds majority of WTO members vote in favour, the applicant is free to sign the protocol and to accede to the organisation. In some cases, the country's own parliament or legislature has to ratify the agreement before membership is complete.

4.12 WTO AND GATT - ARE THEY THE SAME?

According to the WTO (1995a), the WTO is different from the GATT 1947. It improves upon the GATT in terms of the content of the rights and obligations conferred on member countries, the number of countries participating, and its ability to promote trade negotiations and to process trade disputes among its members. There are several key reasons for why the WTO is different from the GATT:

- First, GATT was *ad hoc* and provisional. The General Agreement was never ratified in member's parliaments, and it contained no provisions for the creation of an organisation. On the other hand, the WTO and its agreements are permanent. As an international organisation, the WTO has a sound legal basis because members have ratified the WTO agreements, and the agreements themselves describe how the WTO is to function.

- WTO (1996a) states that the second significant difference is the 'single undertaking' of the WTO agreement. WTO members must accept all of the obligations of the GATT and its corollary agreements (with a few exceptions) negotiated in the Tokyo and Uruguay Round. For many developing countries, the single undertaking commits them to substantially more trade obligations than previously required under the GATT regime. According to Schott (1996), the WTO trading rules allow asymmetric implementation of WTO obligations for developing countries and countries in transition to market economies (i.e., longer periods for them to fully assume those obligations). In addition, the poorest countries are exempted from some requirements. However, in most instances the transition period afforded developing countries before they assume full WTO obligations is relatively short.

- The third distinction between the GATT and the WTO lies in the membership of the organisations. In the WTO, many more countries have either joined or are seeking membership in the organisation than signed onto the GATT in the past, and more countries actively participate than did so under the GATT regime.

- Forth, the GATT deals with trade in goods. The WTO covers issues not covered by world trading rules (e.g., trade in services, trade-related investment measures, and intellectual property rights). WTO obligations apply to a larger share of global commerce than the GATT did.

- Finally the major difference between the GATT and the WTO regimes is the dispute settlement mechanism (DSM). The WTO dispute settlement system is faster; more automatic than the old GATT system and its ruling cannot be blocked. According to Schott (1999), the WTO procedures now operate under strict time limits; Countries cannot veto judgements against them; panel findings are subject to review by a new Appellate Body; and procedures are in place to promote timely compliance, to monitor compliance actions, and to allow retaliation in the event of non-compliance.

4.13 DEVELOPING COUNTRIES AND THE WORLD TRADE ORGANISATION SYSTEM

Over three-quarters of WTO members are developing or least-developed countries. Special provisions for these members are included in all the WTO agreements. According to the World Bank (1995b), the special provisions include:

- Longer time periods for implementing agreements and commitments;
- Measures to increase trading opportunities for these countries;

- Provisions requiring all WTO members to safeguard the trade interests of developing countries;
- Support to help developing countries build the infrastructure for WTO work, handle disputes, and implement technical standards.

In 1997, a high-level meeting on trade initiatives and technical assistance for least-developed countries brought their concerns to centre stage. The meeting involved six intergovernmental agencies and resulted in an "integrated framework" to help least-developed countries increase their ability to trade, and some additional preferential market access agreements.

A committee on trade and development, assisted by a sub-committee on least-developed countries, looks at developing countries' special needs. Its responsibility includes implementation of the agreements, technical co-operation, and the increased participation of developing countries in the global trading system.

4.13.1 TECHNICAL ASSISTANCE AND TRAINING FOR DEVELOPING COUNTRIES

The WTO Secretariat organises a number of programmes to explain how the system works and to help train government officials and negotiators. Some of the events are in Geneva, others are held in the countries concerned.

The WTO organises around 100 technical co-operation missions to developing countries annually. It holds on average three trade policy courses each year in Geneva for government officials. Regional seminars are held regularly in all regions of the world with a special emphasis on African countries. Training courses are also organised in Geneva twice a year for officials from countries in transition, from central planning to market economies.

In 1997-98, the WTO set up reference centres in 40 trade ministries in the capital cities of least-developed countries. These provided computers and Internet access to enable ministry officials to keep abreast of events in the WTO in Geneva through online access to the WTO's immense database of official documents and other material.

4.14 REGIONAL ARRANGEMENT AND THE MULTILATERAL TRADING SYSTEM

4.14.1 THE EXTENT OF REGIONALISM IN THE WORLD ECONOMY

Do regional agreements undermine the multilateral trading system? Does the success of multilateralism necessarily lead to a spread of regionalism? How do regional agreements or more accurately, preferential agreements, affect the enforcement provisions of the WTO?

Regionalism vs. multilateralism is a much discussed topic among trade economists. Winters (1996) defines regionalism as any policy designed to reduce trade barriers between a subset of countries, regardless of whether those countries are actually contiguous or even close to each other. Lahiri (1998) also defined regionalism more broadly as a tendency towards some form of preferential trading arrangements between a number of countries belonging possibly to a particular region. The word preferential is the key word here and it necessarily implies that countries not belonging to a particular regional arrangement are discriminated against. The controversy regarding the desirability of regionalism is not a new one. On the other hand, economists find it difficult to define multilateralism, Winters (1996) states that although multilateralism is a characteristic of the world economy or world economic system, it must ultimately reside in the behaviour of individual countries. This could include the following:

- The degree to which discrimination is absent;
- The extent to which the country's trading regime approximates free trade.

Winters (1996) argues that multilateralism is sometimes referred to as a process whereby countries solve problems in an interactive and co-operative fashion. One of the features of trade policy today is the expansion of regional trade arrangements. In recent years, moves towards regional integration have been more and more active, with countries seeking to strengthen their ties with other countries (see figure 4.3).

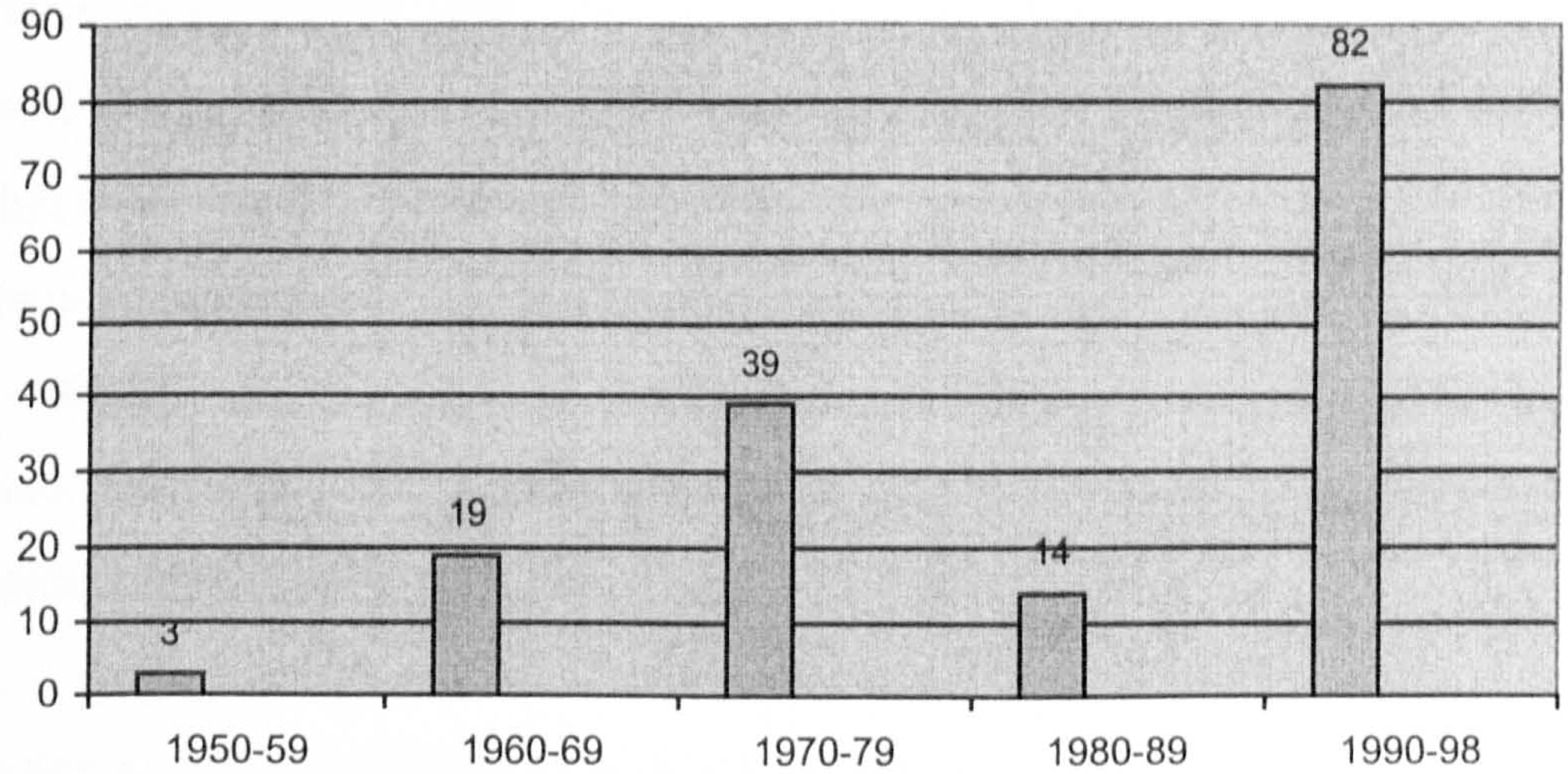


Figure 4.3: Regional Arrangements (1950-1998)

Source: World Bank (1999b)

According to UNCTAD (1999e), in Europe, when the Masstricht Treaty took effect in November 1993, the European Union (EU) was created, which expanded and built upon the European Community. The enlargement of the EC took place on January 1, 1995 with the participation of three countries, Austria, Sweden and Finland, which were former members of the European Free Trade Association (EFTA). Meanwhile, the September 1993 signing of the side agreements to the NAFTA (North American Free Trade Agreement) launched the free trade arrangement in North America in January 1994. Also in the Americas, certain countries in Latin America initiated MERCOSUR (Southern Common Market Treaty) in January 1995. On the other side of the Pacific, the ASEAN Free Trade Area (AFTA) began lowering tariffs among its members in January 1993 and, while expanding the range of items covered, has agreed to begin negotiations on access to service areas. The AFTA nations have also agreed to make efforts toward the acceleration of the integration process with a view to full implementation of AFTA by the year 2000.

According to World Bank (2000g), one of the trends that has recently been observed is the creation of mechanisms for broader regional co-operation. This includes expansion of existing regional integration including the free trade agreement between the EC and the countries of Central and Eastern Europe. A further example is the free trade area that is to be set up between the EC and the countries of the Mediterranean, and the creation of a Free Trade Area of the Americas.

OECD (1999d) states that this trend also includes linkages between regional integration (e.g. economic co-operation, including the creation of a future free trade area between the EC and MERCOSUR), and continent-based regional co-operation that may not necessarily be seeking to create a free trade area or a customs union, (e.g. Asia-Pacific Economic Co-operation (APEC)), efforts to strengthen US/EC relations, including the New Transatlantic Marketplace and the Asia-Europe co-operation touched off by the Asia-Europe Meeting).

There can be no doubt that some regional arrangements have played a positive role in promoting liberalisation, especially for developing countries. According to the WTO (1999i), since the GATT came into force in 1948, nearly 150 regional trade agreements have been notified to the GATT or the WTO. More than 90 preferential regional agreements are currently in place, and over three-quarters of them entered into force in the last four years. And it is not just the pace of regionalism, which is different today, but its breadth of ambition as well (see figure 4.4).

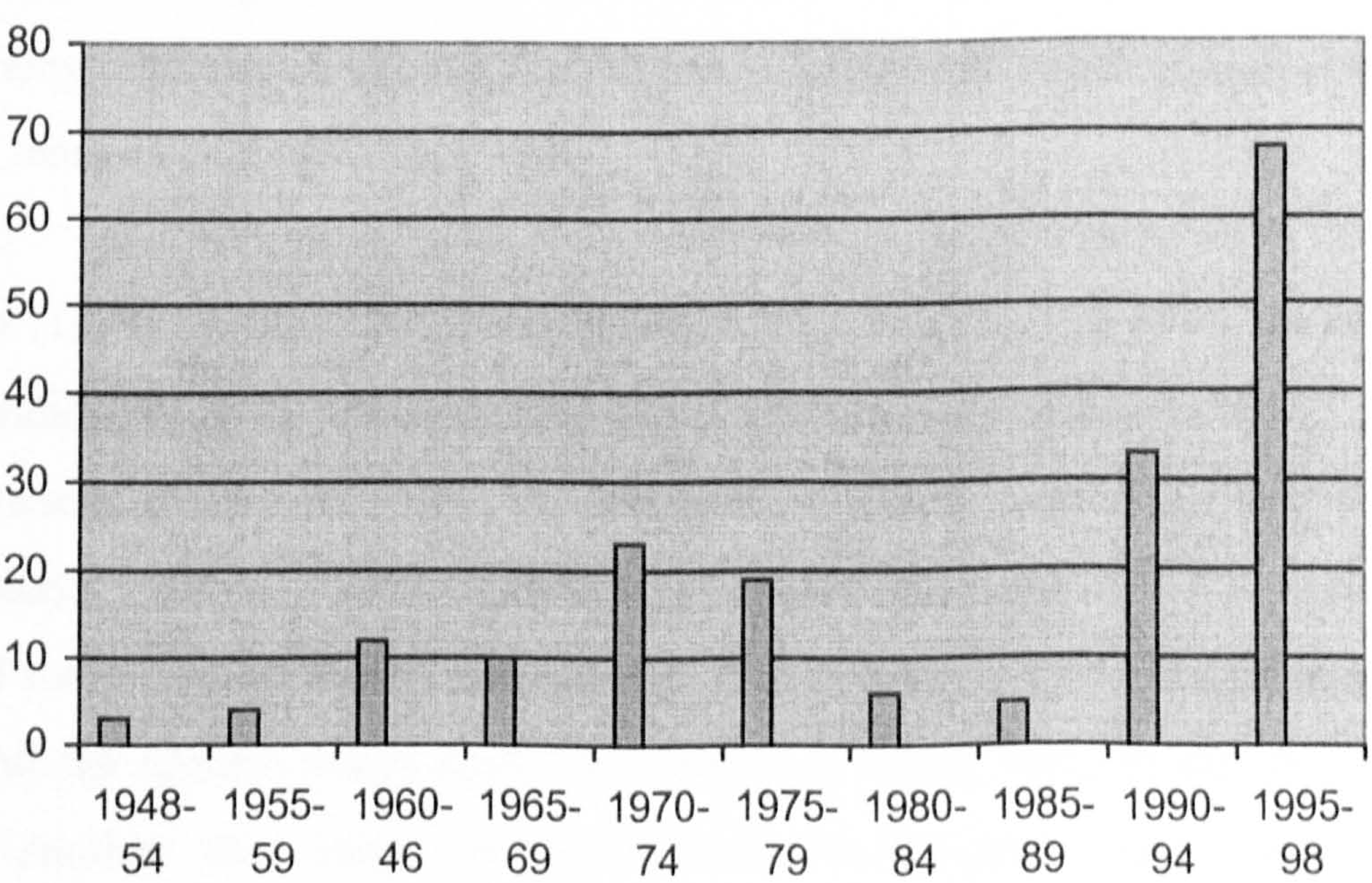


Figure 4.4: Regional Integration Agreements Notified to WTO (1948-1998)
Source: WTO (1999i)

According to Bergsten (1996a), one of the great advantages of the contemporary regional initiatives is that they have kept the bicycle moving forward after the conclusion of the Uruguay Round. The history of trade policy teaches forcefully that failure to move more steadily forward toward liberalisation condemns the trading system to tip over or fall backward in the face of protectionism pressures, "the bicycle theory".

4.14.2 REGIONALISM AND MULTILATERALISM: COEXISTENCE OR CONFLICT?

According to Stephenson (1999), the central argument for regionalism has always been that smaller groups of countries may move further and faster towards integration than in a much wider multilateral system. Moreover, liberalisation at a global level is an ambitious and difficult goal that will most likely move slower than liberalisation at regional level. This is a logical argument because the number of variables increase and this adds to the complexity and speed of change. Furthermore, supporters of regional trade arrangements maintain that these agreements have enabled countries to liberalise trade and investment barriers to a far greater degree than multilateral trade negotiations allow. They also argue that regional arrangements have gone beyond trade liberalisation, taking important steps toward harmonising regulations, adopting minimum standards and practices, and trends that enhance market access (Mikic, 1998).

Bergstan (1999) on the other hand, argues that it is difficult to make the argument that liberalisation is any easier in, say, APEC, the FTAA or between the EC and the Mediterranean countries, than in the WTO. Many of these new regional arrangements contain countries in the multilateral system. And the points of potential trade friction are no less vexing. For example, are negotiations between Japan and the United States really any easier in APEC than in the WTO? Can Europe resolve the issue of agricultural liberalisation any more swiftly transatlantically with MERCOSUR, or across the Mediterranean with the countries of the Middle East and North Africa?

A second point is that the globalisation process itself underscores the logic of global rules for global firms operating in a global marketplace. As firms increasingly internationalise their production and distribution systems, and as economies become increasingly integrated, a fragmented system with fragmented rules, and even perhaps a fragmented dispute settlement system could be very costly. This is even more true in the world of borderless technologies. We are now entering a world where economic activity in areas like telecommunications, financial services, and electronic commerce will more and more take place in a single, global economic space, on which is basically indifferent to geography. In this borderless information economy, regional performance becomes an increasingly inadequate, even anomalous, instrument for managing the integration process.

According to Finger and Schuler (1999), some pessimists see the trend toward regionalism as a return to the past. They believe that the world trading system is fragmenting today just as it did in the 1930s. The rules-based multilateral trading system developed under the GATT and the WTO will be destroyed as Europe, North America and Asia become fortresses in which some trading partners obtain refuge while others are excluded.

Following the same approach, Bahagwati et al (1998) proclaim that the GATT is dead and argues that the world would shift to a tripolar system with blocs centred in Europe, the United States and Japan, which would have free trade internally but managed trade among them.

Bhagwati et al (1998) and other multilateralists are not willing to give the GATT its last rites but remain concerned that the expansion of regionalism will undermine the multilateral system and weaken its thrust toward liberalisation. Bhagwati et al (1998) fear that if some countries gain a vested interest in preferential arrangements, they will have less incentive to press the complete free trade. Furthermore, if leaders devote resources and political capital to their regional arrangements, they could be diverted from investing in the multilateral system. Bhagwati and Krueger (1995) argue that the World Trade Organisation (WTO) should be the sole locus of future trade liberalisation. They therefore call for a more exclusive reliance on global initiatives.

However, according to Whalley and Hamilton (1996), there are more sanguine views. The WTO and many American officials argue that regional arrangements have also been presented as a complement and supplement to liberalisation under the multilateral trading system. By following both regional and multilateral approaches, they argue, world trade liberalisation can proceed more rapidly. Such a multispeed approach to freer trade can achieve greater gains for those willing to proceed faster and at the same time put pressure on the multilateral track to perform better.

Bergstan (1996a) argues that there is a role for both regional and multilateral agreements. Today the motives driving agreements are fundamentally different from those in the 1930s and, those that drove developing countries in the 1950s and 1960s. In contrast with the new regionalism, where the desire was for increased isolation, today countries integrate together seeking greater integration in the global economy.

In the conclusion of a study by the WTO Secretariat (1995a), to a much greater extent than is often acknowledged, regional and multilateral integration initiatives are complements rather than alternatives in the pursuit of more open trade. The report observes that regional agreements have allowed groups of countries to negotiate rules and commitments that go beyond what was possible at the time multilaterally. In turn, some of these rules-for example in services and intellectual property protection, paved the way for the Uruguay Round agreements. Some regional groups have agreements on environmental standards, investment and competition policies; all three issues are mentioned in the final Uruguay Round agreement and are being discussed in the WTO.

The groupings that are important for the WTO are those involving the abolition or reduction of barriers on trade within the group. The WTO agreements recognise that regional arrangements and closer economic integration can benefit countries, and that, under some circumstances, regional trading arrangements could hurt the trade interests of other countries. Normally, setting up a customs union or free trade area would violate the WTO principle of equal treatment for all trading partners (The Most Favoured Nation principle). But Article 24 of GATT allows regional trading arrangements to be set up as a special exception, provided certain strict criteria are met. In particular, the arrangements should help trade flow more freely among the countries in the group without barriers being raised on trade with the outside countries. In other words, regional integration should complement the multilateral trading system and not threaten it.

Article 24 of GATT says if a free trade area or customs union is created, duties and other trade barriers should be reduced or removed on substantially all sectors of trade in the group. Non-members should not find trade with the group any more restrictive than before the group was set up.

Similarly, Article 5 of the General Agreement on Trade in Services (GATS) provides for economic integration agreements in services. Other provisions in the WTO agreement allow developing countries to enter into regional or global agreements that include the reduction or elimination of tariffs and non-tariff barriers on trade among themselves.

At the WTO first Ministerial Conference in Singapore in 1996, every Minster reaffirmed the primacy of the multilateral trading system. According to Mattoo (2000b), they did so for an important reason, a collective recognition that while regionalism can provide an important complement to the multilateral system, it cannot provide a substitute. Earlier in 1996, WTO members had also created the Committee on Regional Trade Agreements whose tasks were to be:

- To examine regional agreements notified to the WTO, and to assess whether they are consistent with WTO rules;
- To formulate procedures to improve the examination process;
- To define reporting obligations for regional agreements and practical arrangements for carrying out these obligations;
- To consider the systemic implications of regional arrangements for the multilateral trading system;
- The committee is also examining how regional arrangements might affect the multilateral trading system, and what the relationship between regional and multilateral arrangements might be.

There are two broad dimensions to these tasks the first is to ensure that the foundation of the trading system remains non-discrimination, and that regional agreements do not introduce trade distortions and penalise the trade interests of third parties.

According to the EIU (1996), both the GATT and the GATS contain provisions to accommodate regional agreements. In essence, GATT Article XXIV requires that substantially all trade among members of regional groupings must be free, and that in the case of customs unions, barriers against the trade of third parties are on average no higher after the formation of a grouping than they were before. Article V of the GATS is framed in the same spirit of seeking to protect the trade interests of countries that do not form part of regional arrangements. The GATS provisions require that economic integration agreements have substantially all discrimination among parties to such agreements. Notwithstanding the intent of these rules, the fact remains that regional agreements, which are preferential by nature, represent an exception to the Most Favoured Nation (MFN) principle. If the number and extension of these exceptions to MFN reach a sufficiently significant level, the exception could become the rule and the multilateral system would be substantially changed. Ethier (1998b) states that the WTO goal must be to make regionalism contribute to multilateralism, not vice versa.

The second challenge is to ensure that regionalism and multilateralism are covered in their goals and aspirations which ensure that multilateral goals remain at least as ambitious as regional efforts. Governments have already agreed to the aim of free trade in the Pacific, free trade in the Americas, free trade in Europe and between Europe and the Mediterranean. According to Foroutan (1998), now there is the prospect of creating new free trade areas between Europe and the nations of Sub-Saharan Africa, the Caribbean and the Pacific and there is the possibility of free trade across the Atlantic. Each of these initiatives is planned to come into full effect within the next twenty years.

On the other hand, although the WTO took a step to ensure the process of liberalisation at both regional and multilateral level by establishing the Committee on Regionalism, Winters (1998) points out that the problem is not so much the ambiguous drafting of WTO obligations as the absence of disciplines over regional trading rules (such as rules of origins and anti-dumping) that have a significant impact on trade. Consultations and monitoring by the new committee on regionalism are a necessary response to these problems, but insufficient. According to IIE (1996), two other WTO initiatives are needed.

The best and simplest solution would be to reduce MFN barriers to a low level so that regional preferences have little residual value. If MFN tariffs are low, there is little need to distinguish between the trade of regional members and non-member countries.

To that end, the IIE (1996) states that WTO members should commit to avoiding new trade discrimination by working with their regional partners to lower MFN trade barriers commensurate with their regional liberalisation.

Second, WTO members should strengthen WTO rules and guidelines in areas that regional arrangements are prone to abuse.

Lahiri (1998) suggests solutions to the conflict between regional arrangements and multilateral discipline. First, to pursue further multilateral trade liberalisation in order to limit the margin of preference that regional agreements create. Policymakers who believe that their country is suffering because of the rise of regional trade arrangements elsewhere thus have a further incentive to support multilateral trade liberalisation. Second, to alter the WTO's agreement on regional trading arrangements (RTA) in order to commit members to phase out any preferential market access as a temporary feature of any regional initiative. To make this approach more attractive to members of a regional initiative, they could offer credit for a reduction in trade barriers, which could be used in future multilateral trade negotiations.

Third, to negotiate a "model accession clause" for the principal types of RTAs. Such clauses contain a set of conditions non-members must meet in order to become members. Meeting the conditions automatically triggers a negotiation for accession to the regional arrangements. These clauses could also ensure that the trade barriers that non-members face do not arise when a RTA is established or when new members are admitted.

4.15 TRADE, POLITICAL STABILITY AND THE MULTILATERAL TRADING SYSTEM

According to Destler (1996), trade is part of a global strategy to promote both economic prosperity and political stability. In the 1940s and 1950s, trade was seen as a key element in maintaining and promoting peace among nations. This was one of the central factors behind the drive towards multilateral free trade. Stephenson (1999) states that at least three reasons can be given as to why trade and peace are closely inter-related, and why integration through trade promotes world peace. First, trade reduces the likelihood of conflict by establishing vested interests in the welfare and prosperity that trade helps to bring about. Second, trade generates information about other countries and cultures and builds relationships among people across countries. Third, trade helps to build peace-oriented structures, including international rules. In short, mutually beneficial contact fosters co-operation, not conflict.

Moreover, Wolf (1996) suggested that there may be indirect links between trade and peace. According to the theory of comparative advantage, trade makes countries and many individuals richer, thereby raising the likelihood that democracy will prevail. Democratic societies with pluralistic decision-making processes are less likely to go to war than autocratic societies where demagoguery holds way.

On the other hand, Bergsten (1999) argues that trade policy could become a source of international instability and conflict if policies are not bound in a multilateral context. Protectionist measures and trade policy reversals negatively affect foreign producers, thus raising tensions among countries. For instance, trade protection caused serious adjustment problems and dislocations during the Great Depression, as jobs disappeared and people's livelihoods were threatened. This triggered further protection and competitive devaluation, leading to a complete collapse in trade.

In the light of these experiences, Bhagwati et al (1998) feel that the multilateral trading system has to be understood as part of post war order for which the promotion of peace was among the prime objectives. According to Ethier (1998b), the multilateral trading system is designed partly with this in mind; for instance, first, the dispute settlement mechanism has elements of an international judiciary which rules trade policy behaviour, thereby lessening the scope for destructive conflict. Second, by establishing non-discrimination as the bedrock of the system, the MFN rule helps to take the politics out of trade, allowing rules to prevail over power. MFN also reduces the uncertainty emanating from shifting negotiating power and international coalitions, and imparts a sense of fairness trade policy. It also makes it more costly for governments to reserve trade policy commitments.

Third, National Treatment prevents conflicts arising from the circumvention of trade liberalisation through domestic policies. Fourth, safeguard provisions also intended to control and limit protectionist backtracking, while at the same time recognising that overriding domestic considerations may require a temporary suspension of commitments. And finally, Progressive Liberalisation helps to focus countries energies on competing in increasingly open world markets, where the size of the economic pie is growing and there is less interest in redistributing existing wealth than in a stagnant world.

4.16 TRADE AND THE ENVIRONMENT

As environmental issues have risen to the forefront following the Rio Earth Summit, the debate has intensified over the links between trade and the environment, and the role of the WTO to promote environmentally friendly trade. According to Esty (1998), the clash between environmental and trade policies has a number of origins. One is the higher profile now given to environmental issues in the political arena at local, national and regional levels. Another is the ambiguity over how trade rules relate to environmental issues and the past lack of clear determination on environmental issues under the WTO.

Anderson (1998) states that the central argument for those who have raised the profile of this issue in the WTO is that there are circumstances where trade liberalisation may have harmful environmental effects. Three main arguments are forwarded as to how this might occur.

First, trade can have adverse consequences on the environment when property rights in environmental resources are weakly defined or prices do not reflect scarcity. This situation results in production or consumption and can lead to the abuse of scarce environmental resources and degradation, which is expected through trade. Some of the pollution can be purely local, such as a very noisy factory. Other pollution can have global repercussions, for example, the excessive emission of greenhouse gasses, the destruction of rainforests, and so on.

The second argument linking trade and the environment is closely related. According to the World Bank (1999b), if some countries have low environmental standards, industry is likely to shift production of environment-intensive or highly polluting products to so called pollution havens, which trade liberalisation can make more attractive. If these industries then create pollution with global adverse effects, trade liberalisation can, indirectly, promote environmental degradation. Worse, trade-induced competitive pressure may discourage the implementation of more stringent domestic environmental requirements.

According to Esty (1998), the third concern of environmentalists relates to social preferences. Some practices may simply be unacceptable for certain people or societies, so they oppose trade in products, which encourage such practices. These can include killing dolphins in the process of catching tuna, using leg-hold traps for catching animals for their furs, or the use of polluting production methods which have only local effects.

On the other hand, a study conducted by the World Bank (1999b), showed that trade liberalisation may improve the quality of the environment rather than promote degradation. First, trade stimulates economic growth, and growing prosperity is one of the key factors in societies' demand for cleaner environment. Growth also provides the resources to deal with environmental problems at hand-resources which poor countries often simply do not have.

Second, the UNCTAD (1999e) states that trade and growth can encourage the development and dissemination of environmentally friendly production techniques as the demand for cleaner products grows and trade increases the size of markets. Esty (1998) claims that international companies may also contribute to a cleaner environment by using the most modern and environmentally clean technology in all their operations. This is less costly than using differentiated technology based on the location of production and helps companies to maintain a good reputation.

Finally, the costs of meeting environmental regulations often accounts for only a small fraction of total production costs, so that this factor is unlikely to be at the basis of relocation decisions, other factors such as labour costs and the adequacy of infrastructure are much more important.

In practice, the impact of trade on the environment is largely an empirical question (Anderson, 1998). Trade-related empirical studies have focused largely on the role of trade in promoting pollution havens and the race to the bottom, and the role of growing income in increasing demand for more environmental protection. Experience shows that trade may not add in a significant way to environmental problems, beyond those that arise through economic activity generally (Whalley, 1995). On the other hand, restrictive trade policy is not the solution to environmental problems. The solution lies instead in the use of appropriate environmental policies.

The OECD (1999b) pointed out that, in recognising the importance of the trade and the environmental policy linkage, the General Council of the WTO at its first meeting decided to establish a Committee on Trade and Environment (CTE). But little progress has been made on the environmental front since the committee launched.

Ensuring that the international trading system reflects sufficient sensitivity to environmental matters and that environmental regulation does not become an obstacle to trade remain the important challenges for the WTO.

4.17 DEVELOPING COUNTRIES AND MULTILATERAL TRADING SYSTEM

According to the OECD (1997a), trade liberalisation benefits economies in two important ways. First, when tariffs are lowered and relative price changes, resources are reallocated to production activities that raise national incomes. The tariff reductions implemented after the Uruguay Round raised national incomes by 0.3 to 0.4 percent. Second, much larger benefits occur in the long run as economies adjust to technological innovations, new production structures and new patterns of competition. These gains will continue to be as important in the future as they have been in the past.

The success of the international trading system in fostering ever-stronger economic linkages between national economies has highlighted the uneven division of the benefits of the globalisation process. Parker (1998) argues that the international trading system owes its robust development to successful institutions that straddle international and national levels, for many decades the GATT and now its successor, the WTO.

According to Mikic (1998), the trade liberalisation resulting from the Uruguay Round and from regional integration, combined with the autonomous liberalisation measures of developing countries, have created both opportunities and challenges for promoting economic growth and sustainable development. The economic impact of these liberalisation efforts will, however, be spread over a number of years because the Uruguay Round Agreements provide for a phased implementation of commitments and because economies will take time to adjust to policy changes.

Meanwhile, there are likely to be transitional impacts of trade liberalisation. The OECD (1999b) states that globalisation does not benefit everyone equally. Developing countries and the least developing countries are always the least able to take advantage of the opportunities that globalisation presents, and globalisation may lead to an increase in inequality in these countries.

The question of how to facilitate the economic and institutional integration of developing countries and countries in transition into the world trading system and at the same time offer a more equal sharing in its benefits is a major challenge for international economic co-operation. The OECD (1999c) states that it is also an issue of special interest to developed countries. The gains to industrial countries from increased trade integration with developing countries are potentially larger than the gains from additional integration among themselves. Trade integration arising from the ongoing liberalisation process and from its extension to new areas such as services, is likely to generate dynamic gains from increased market size, competition and technology transfer. Nicolaides (1998) states that as developing countries are forecast to grow about twice as fast as industrial countries, and as countries in transition develop stronger supply capacities and become more competitive internationally, the dynamic gains from increasing trade with them are likely to be especially important.

The World Bank (1999b) states that an effective WTO serves the interests of developing countries in four ways:

- It facilitates trade reform;
- It provides a mechanism for settling disputes;
- It strengthens the credibility of trade reforms;
- It promotes transparent trade regimes that lower transactions costs.

These benefits explain the willingness of developing countries to join the WTO in increasing numbers. In 1987, 65 developing countries were GATT members. In 1999, 110 non-OECD countries were members of the WTO, accounting for approximately 20 percent of world exports (see figure 4.5).

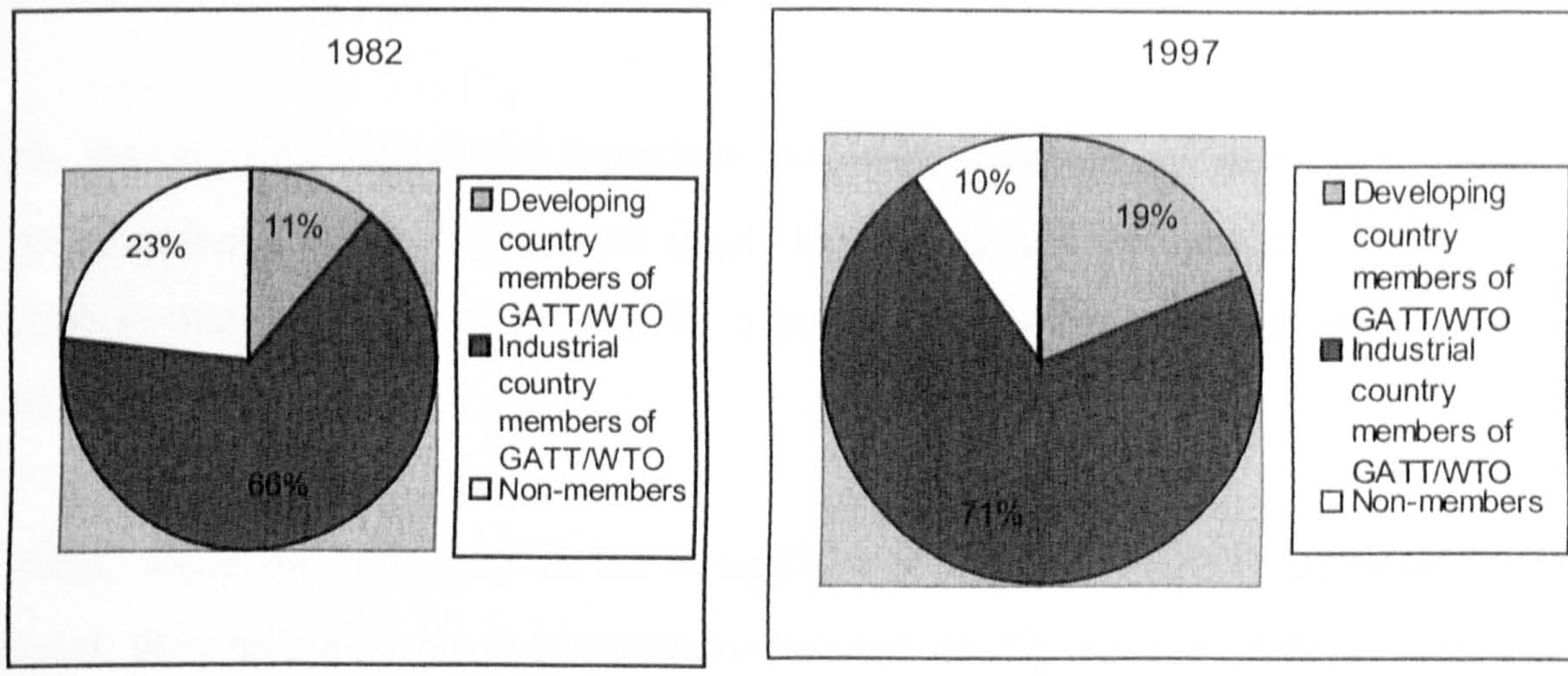


Figure 4.5: Share in Total World Exports

Source: World Bank (1999b)

UNCTAD (1996b) states that the realisation of these gains will, however, depend on the extent to which the adjustments required by the process of integration are carried out. International trade can only fulfil its potential as an engine of global economic growth if the necessary reallocation of resources in line with countries' different and changing comparative advantage is allowed to take place and the inevitable frictions and protectionist pressure that will arise in implementing appropriate structural adjustment policies are resisted. Furthermore, the weaker trading partners, especially the LDCs and commodity-dependent economies, must be permitted to strengthen their economic, technical and human capacities to engage in trade and to participate fully in the multilateral trading system.

According to OECD (1998b), not all-developing countries are equally able to seize the new opportunities for international trade that are likely to arise from the process of globalisation. For example, the speed of integration in international trade of LDCs since 1990, measured by the differential between the growth rate of trade and output, has only been one third as fast as that of developing countries as a group. These countries and other structurally weaker economies are also poorly equipped to participate in the multilateral system of trade rules and disciplines. The danger of marginalisation of a large number of countries in the international trading system is therefore real.

Trade liberalisation might affect developing countries in the following ways:

First, varying time lags in the expansion and contraction of industries due to policy changes induced by the Agreements imply that the factors released from contracting industries may remain unemployed for a period before they become reabsorbed in expanding industries.

Second, while the reduction in MFN tariffs will increase market opportunities in general, they will also put a competitive squeeze on the exports of those countries whose access was hitherto facilitated by preferential tariffs. These countries are likely to experience a transitional loss of export revenue. Other short-term effects are expected as a result of the reform process in agriculture which could lead to higher prices for basic food products and therefore involve transitional costs in terms of higher import bills for low-income food-deficit developing countries. On the other hand, an extended and stricter patent protection is likely to result in higher prices for high technology and pharmaceutical products (See for example, UNCTAD, 1998b).

On the other hand, the WTO (1999d) argues that it provides a rules-based multilateral trading system. All members have both rights and obligations. The alternative is bilateral commercial relations based on economic and political power; small countries are then at the mercy of the larger trading powers. Differences in influence between individual countries remain, of course, but even the smallest WTO member has a wide range of rights, which are enforceable under the WTO's impartial dispute settlement procedures.

According to the OECD (1999a), developing countries gained many advantage from the Uruguay Round: stronger rule-based system, more power when the WTO handles disputes, a strengthened hand in introducing domestic reforms and special provisions for developing countries in the WTO agreements.

The most important benefit is the major strengthening of the rules-based multilateral trading system. This is of particular importance to small and medium-size trading nations. If commercial relations were based on economic and political strength, the lower-income developing countries would be virtually helpless and therefore increasingly dependent on richer and more powerful countries. Their situation would be nearly as bad if multilateralism were rejected in favour of an exclusive focus on regionalism. Had the Uruguay Round not been held - worse, if it had failed - economic and political power would have come to dominate commercial relations. In that sense, rules-based multilateralism is a declaration of economic and political independence for less powerful countries.

Furthermore, the WTO (1999i) states that some of the outcomes of the Uruguay Round are particularly important for developing countries. First, the Uruguay Round significantly strengthened the dispute settlement procedures. Individual countries, no matter how big, can no longer block the process. Even more than before, the lower-income developing countries are in a position to defend their rights and to insist that other members fulfil their legal obligations as laid down in the WTO's rules.

Second, the increase in market access provides opportunities to increase and diversify exports through the following:

- The initial steps in a fundamental reform of agricultural policies that affect trade;
- The phase-out of quotas on developing countries' textiles and clothing exports;
- Reductions in industrial tariffs and an increase in tariff bindings by a broad cross-section of actual and potential trading partners;
- The decision to phase-out so-called "grey area measures" (bilateral quantitative restrictions other than those on textiles and clothing.

Third, the Uruguay Round Agreements are a "single undertaking", requiring all WTO members to accept the same rights and obligations. This was not the case under the former GATT where many lower-income members undertook fewer obligations than developed countries. Those obligations, including additional disciplines, can be very helpful to reform-minded governments. Policy discretion is a two-edged sword. It gives governments freedom, but it also allows them to change their policies frequently, sometimes in response to the demands of politically powerful special interest groups, not necessarily acting in the country's overall interests. The credibility of economic reforms can then be undermined, discouraging both domestic and foreign investors and making domestic and foreign investors hesitant to commit funds to projects other than those, which promise a very quick pay-off. Therefore, the "burden" of accepting additional multilateral disciplines on one's own trade-related policies, can often be a blessing in disguise for a government interested in promoting economic growth and development.

Fourth, the Uruguay Round results include a large number of provisions intended to benefit specifically the WTO's LDC members. These include provisions which recognise developing countries' interests, in particular in their trading partners' markets. They also include provisions allowing the LDCs more time to implement some obligations. Some provisions also prescribe technical assistance. At the first ministerial meeting of the WTO at Marrakech (1994), trade Ministers also adopted:

- The Decision on Measures in Favour of Least-Developed Countries;
- The Decision on Measures Concerning the Possible Negative Effects of the Reform Programme (for Agriculture) on Least-Developed and Net Food-Importing developing Countries;
- The Declaration on the Contribution of the World Trade Organisation to Achieving Greater Coherence in Global Economic Policy Making which includes specific references to issues of importance to the lower-income countries.

Fifth, the Uruguay Round will boost global GDP and stimulate global demand for the exports of lower-income developing countries. Estimates of the increase in global GDP from the market access part of the Uruguay Round range from $40 billion to $315 billion in 1992 dollars, part of which will be spent on goods and services exported by the lower-income developing countries. In fact, these figures almost certainly underestimate the global gains because they completely ignore the stimulus to world GDP by strengthened rules and procedures, the extension of multilateral rules to trade in services and other advances whose effects cannot be quantified.

The claim that many of the developing countries will be net losers from the Uruguay Round does not stand up under close examination (Harrison et al, 1997). Indeed, from some points of view, these countries could end up among the principal gainers from the Uruguay Round. They are likely to gain, perhaps more than anyone else, from a strengthened multilateral trading system, from the phase-out of quantitative restriction on textiles and other products, and from the opportunities to use new WTO obligations to promote badly needed domestic economic reforms.

The likelihood of adjustment pressures on developing countries was recognised at the Marrakech Ministerial Meeting in 1994 (UNCTAD, 1999b). As a result, the Uruguay Round Agreements incorporate a range of measures aimed at spreading out the adjustment process in order to minimise costs. These measures should, however, be complemented by a positive approach designed to smooth the process of economic adjustment by addressing the rigidities, which slow it down. International support should be mobilised for the efforts by developing countries to rationalise resource allocation and develop supply capabilities, as well as to increase the elasticity of supply in critical areas by encouraging investments in food production and non-traditional export industries and in labour retraining schemes.

Hoekman (1995) argues that special attention should be paid to the contribution of the services sector to development and the role of trade in services in the integration of developing countries and economies in transition into the world economy. According to Brown and Deardorff (2000), giving the rising service intensity of production, a strong producer services sector has a major impact on the competitiveness of firms and of the economy as a whole, and consequently on the chances of success of export-oriented development strategies. Moreover, global competition is now characterised by a declining trend in the share of profits arising from product-or process-based comparative advantage, with a correlative increase in profitability and competitiveness based on information advantages and reductions in transition costs. Strengthening service capacities in general, and capacities for trade efficiency in particular, is thus a major challenge for developing countries in the period ahead.

Whalley (1995) argues that particular difficulties are faced by the primary commodity export-dependent developing countries when using international trade as an engine of economic growth and sustainable development. These are mostly low-income countries, with a large proportion located in Sub-Saharan Africa. Because of their heavy commodity dependency, the economies of these countries tend to be highly vulnerable: generally, they are characterised by a high degree of export-earnings instability, a persistent decline in the terms of trade, a high external debt burden, small inflows of foreign direct investment and limited developmental linkages within the domestic economy.

According to Francois et al (1995), in sum, the immediate task for national and international policy is to secure an advanced role in world trade for developing countries and countries in transition through export expansion and diversification, in terms of both products and markets. This objective can be promoted through policies and actions designed to strengthen supply capabilities and capacities for trade efficiency, to improve market access, and to help the weaker countries overcome transitional difficulties and constraints arising from commodity dependence. Institutional integration can be promoted by helping countries to participate actively in the multilateral decision-making process, to meet their new obligations deriving from the Uruguay Round Agreements and to defend their rights effectively. As for non-members of the WTO, it also involves facilitating accession to the Organisation. Integration can also be promoted through strengthening the ability of developing countries to formulate and pursue autonomous trade liberalisation policies, as well as by strengthening regional integration to enable them to diversify markets and take full advantage of global trading opportunities.

4.18 SUMMARY

The world economy has attempted to embrace trade liberalisation as a means to achieving growing prosperity and peace. The attempts have included trading agreements at both regional and global levels so that the harsh repercussions of protectionism that were so destructive during the depression years of the past can be avoided. There is little doubt that global agreements such as GATT and GATS have had an impact on the way in which and the extent to which, countries trade with each other. However, the success of such instruments relies upon markets behaving in a Ricardian manner, incorporating the fluidity and transparency that form the substance of those markets.

The history of the last century provides clear evidence of globalisation and internationalisation but yields a mixed result with respect to the effectiveness of agreements in achieving some of their declared objectives. For instance, both GATT and GATS have attempted, in their own ways, to provide a level-trading environment in which suppliers are competing on equal terms irrespective of the nationality of the supplier. The logic that underpins the structures put in place to achieve this noble aim is sound, but businesses do not start on level fields. To this end the WTO, if successful in its aims, is providing a level field for unequal players and this will make the less powerful businesses, particularly those in developing countries.

There is little doubt that the World Trade Organisation has assisted the growth of international trade in goods and services by expanding its agreements and attracting a wide range of Members. Transparency and stability has been achieved in many areas where previously companies were often 'flying blind'. But there are a wide range of issues that have been raised with respect to the practical implications associated with these agreements and many of them have yet to be fully addressed.

CHAPTER FIVE

THE GENERAL AGREEMENT ON TRADE IN SERVICES

(GATS)

5.1 INTRODUCTION

The area of services is rapidly becoming important in economic terms for developed and developing countries alike. It is now accepted that services play a critical role in determining both the quality and spread of the process of economic development, and that a competitive economy cannot exist without an efficient and technologically advanced service sector (Stephenson, 1999). Despite this realisation, many service sectors remain closed, from a trading point of view, especially for the majority of developing countries.

According to the World Bank (1999b), since the mid 1990s, interest has grown in the area of services liberalisation and the challenges it poses, which are quite different from those found in the trade of goods. The fact that barriers to trade in services are present in national economies in the form of legislation and administration, is not so obvious because, by their very nature they are less transparent. Moreover, there is not always a clear line between a measure affecting trade in services and a barrier affecting trade in services. What one government may feel is a necessary regulatory measure, applied in a non-discriminatory manner, may in fact constitute a *de facto* trade barrier to a foreign services supplier. What is clear, however, is that all-regulatory measures which are applied to foreign providers of services in a discriminatory manner constitute barriers to trade.

One of the major results of the Uruguay Round was the creation of the General Agreement on Trade in Services (GATS). According to the GATT (1994), the GATS is the first multilateral legally enforceable agreement to cover international trade and investment in services, it establishes rules and disciplines on policies affecting access to service markets. Hoekman (1995) claims that in some respects it is a landmark achievement, in other respects it can be considered a failure. It is a landmark in terms of creating multilateral disciplines in virgin territory, a failure in terms of generating liberalisation.

The GATS aims to end arbitrary regulatory intervention, and assure predictability of laws, to generate growth in trade and investment (WTO, 1995a). It creates a framework of multilateral principles and rules for the liberalisation of trade in services, with due respect for national policy objectives and the level of development of each member. Because regulations reflecting these objectives affect the supply of services in various ways, GATS obligations arise from negotiations, rather than flowing directly and automatically from adherence to the framework Agreement itself. The end result of these negotiations appears in the schedule of specific commitments of each member (EC, 1998a). A country cannot become a member of GATS without having accepted at least some specific commitments that, once undertaken, are conditioned by the basic principles to assure affective market access. There are disciplines, with respect to market access, national treatment, and various regulatory matters, that have to be respected by members. In addition, to avoid circumvention or nullification of obligations undertaken, a number of other disciplines also apply to trade policies and practices.

UNCTAD and the World Bank (1995) state that the set of rules of the GATS attempts to produce a more level competitive field. "It ensures that standardised signs, indicating limitations and restrictions, are erected by the roads along which business firms need to drive for exports. It also sets the traffic management code that governments have to abide by, when laying down the rules and positioning the signs" (UNCTAD, 1998f, p.32). Brittan (1998) states that commitments made in the Uruguay Round on services are best described as bound standstill agreements for policies pertaining to specific sectors.

Tourism plays a leading role in the growth of trade in services. Despite the realisation of the importance of tourism to the international economy, there is a range of restrictive practices that has impeded trade in tourism (Fletcher et al, 1999). If the barriers to worldwide travel were eliminated or reduced substantially, international trade in tourism services would increase dramatically. The GATS Agreement goes someway to overcoming the barriers affecting trade in international tourism.

Fletcher et al (1999) argue that there are strengths as well as weaknesses of the GATS in general and in terms of tourism in particular. The main issue is whether the GATS is redressing imbalances or impeding world trade in tourism.

This chapter will discuss first, what the GATS does to bind current trade in service policies and whether it has established a mechanism that is likely to induce significant liberalisation in the future. Secondly, it examines the implications of GATS for the tourism industry and assesses who the losers and the winners are under the operation of GATS. Third, the chapter will discuss the weakness of the GATS in general and for tourism.

5.2 MAIN CHARACTERISTICS AND OBJECTIVES OF GATS

5.2.1 CHARACTERISTICS OF GATS

5.2.1.1 Liberalisation Not Deregulation

According to the GATT (1994), liberalisation of service trade should not be confused with deregulation. Many service industries must and will remain carefully regulated in the public interest. The GATS therefore makes a distinction between trade barriers that distort competition and restrict access to markets on the one hand, and regulations that are necessary to pursue legitimate policy objectives and ensure the orderly functioning of markets on the other. For example, restrictions on the number of suppliers of a certain service or discrimination against foreign suppliers are considered barriers to trade in services and are in principle subject to liberalisation in negotiations. On the other hand, requiring compliance with technical standards or qualifications, requirements that aim at ensuring the quality of the service and the protection of public interest, are considered a necessary form of regulation.

According to the UNCTAD (1996c), through the process of progressive liberalisation, the GATS aims to reduce and eventually eliminate trade barriers while not restricting the ability of governments to maintain and develop necessary regulation to meet national policy objectives. It also recognises the particle need of developing countries to develop appropriate regimes to regulate services.

5.2.1.2 New Definition of Trade

International trade has normally been understood as involving only the movement of goods and services across national borders (EC, 1998c). Because the delivery of services very often requires the physical presence of the person or company supplying the service in the export market, the definition of trade in the GATS has to be much more comprehensive. It covers not only the supply of services across national borders but also transactions that involve the cross-border movement of factors of production (capital and labour). Thus, the sale of an insurance policy in country A by a local branch of a company owned in country B is under the GATS definition a service exported from B to A. Services supplied by an individual service supplier in a foreign country are also regarded as exports from that person's country of origin.

5.2.1.3 Relationship to Domestic Regulation

According to the WTO (1995b), the expanded definition of international trade under the GATS, to encompass cross-border movement of factors of production, means that the GATS has an impact on a far wider range of domestic policy and regulation than the GATT. For example, the national treatment obligation in the GATS concerns not only the treatment of the service (the product) but also the treatment of the business or person supplying the service. Therefore, domestic regulations relating to the treatment of foreign investment and foreign personnel in their service-supplying activities are directly relevant to the obligations of members under the GATS. The GATS is the first multilateral agreement containing obligations on the treatment of foreign investors. It does not cover investment policies per se but does so to the extent that they relate to the supply of services.

5.2.2 GATS OBJECTIVES

5.2.2.1 Progressive Liberalisation of Trade in Services

According to Kakabadse (1994), the GATS is designed to secure progressively higher levels of liberalisation of trade in services through successive rounds of negotiations, which should aim at promoting the interests of all members of the WTO and at achieving an overall balance of rights and obligations.

5.2.2.2 Promoting Economic Growth and Development

One of the important objectives of the GATS is to improve trade and investment conditions through multilaterally agreed disciplines. This liberalisation will promote economic growth and the development of developing countries, and will stabilise trade relations through policy bindings on a MFN basis.

5.2.2.3 Increasing Participation of Developing Countries

The GATS helps developing countries to take a growing part in world trade in services and to expand their services exports. It aims at developing their export capacity and securing export opportunities in sectors of export interest to them.

5.3 INSTITUTIONAL PROVISIONS OF GATS

According to the EC (1998a), the GATS is administered by the WTO, as are all the elements of the Uruguay Round package. The constitution and structure of the WTO and the powers of its Ministerial Conference and General Council were described in Part B of the agreement.

The WTO (1994) states that the Council of Trade in Services operates under the general guidance of the General Council, and is charged with overseeing the functioning of the GATS. It is open to representatives of all WTO members, and meets as often as necessary, establishing its own rules of procedure. In accordance with GATS Article XXIV, the Council for Trade in Services has a large mandate: it may do anything to facilitate the operation of the Agreement and further its objectives. It can establish subsidiary bodies as required, that can, in turn, establish their own rules of procedure, subject to the approval of the Council for Trade in Services.

According to Chadha (2000), there is a provision of the WTO that permits the General Council to make appropriate arrangements for consultation and co-operation with non-governmental organisations. Private organisations are not party to the WTO, and since they do not have any rights under it, they should ensure that their positions are made known through their respective governments.

The WTO (1995b) argues that the role of intergovernmental and non-governmental organisations involved in standard setting and criteria for recognition is explicitly recognised. The GATS encourages members to work in close co-operation with the relevant private sector organisations wherever appropriate.

5.4 STRUCTURE OF THE GATS

According to the GATT (1994), the GATS consists of two parts. The first part is the general framework with its articles and annexes containing general principles and obligations. The second part is the schedules of specific commitments undertaken by each member on national treatment and market access. The schedules are an integral part of the Agreement. While the text of the Agreement applies uniformly to all members of the WTO, the scheduling of commitments is decided by the member concerned, subject to negotiation and agreement with other commitments in a manner commensurate with its level of development. It is thus accepted that developing countries are likely to accept a narrower range of commitments than the developed countries (see box 5.1).

Box 5.1: The Structure of the General Agreement on Trade in Services (GATS)

PART I	**SCOPE AND DEFINITION**	
Article	I	Scope and Definition
PART II	**GENERAL OBLIGATIONS AND DISCIPLINES**	
Article	II	Most-Favoured-Nation Treatment
Article	III	Transparency
Article	III bis	Disclosure of Confidential Information
Article	IV	Increasing Participation of Developing Countries
Article	V	Economic Integration
Article	V bis	Labour Markets Integration Agreements
Article	VI	Domestic Regulation
Article	VII	Recognition
Article	VIII	Monopolies and Exclusive Service Suppliers
Article	IX	Business Practices
Article	X	Emergency Safeguard Measures
Article	XI	Payments and Transfers
Article	XII	Restrictions to Safeguard the Balance of Payments
Article	XIII	Government Procurement
Article	XIV	General Exceptions
Article	XIV bis	Security Exceptions
Article	XV	Subsidies
PART III	**SPECIFIC COMMITMENTS**	
Article	XVI	Market Access
Article	XVII	National Treatment
Article	XVIII	Additional Commitments
PART IV	**PROGRESSIVE LIBERALISATION**	
Article	XIX	Negotiation of Specific Commitments
Article	XX	Schedules of Specific Commitments
Article	XXI	Modifications of Schedules
PART V	**INSTITUTIONAL PROVISIONS**	
Article	XXII	Consultation
Article	XXIII	Dispute Settlement and Enforcement
Article	XXIV	Council for Trade in services
Article	XXV	Technical Co-operation
Article	XXVI	Relationship with Other International Organisations
PART VI	**FINAL PROVISIONS**	
Article	XXVII	Denial of Benefits
Article	XXVIII	Definitions
Article	XXIX	Annexes

Annex on Article II Exemptions
Annex on Movement of Natural persons Supplying Services under the Agreement
Annex on Financial Services
Annex on Telecommunications
Annex on Air Transport Services
Annex on negotiations on Basic Telecommunications

Source: WTO (1995a)

5.4.1 THE GENERAL FRAMEWORK AGREEMENT

The GATT (1994) states that there are six parts to the general framework Agreement:

Part I Scope and definition: has a single Article defining trade in services by listing four different ways in which a services can be traded internationally, that are usually referred to as the four modes of supply.

Part II General obligations: is the main body of the Agreement, and includes the general obligations and disciplines. Principles are stated and the rules derived from them, including the basis for exceptions.

Part III Specific commitments: lays down exactly how specific commitments are to be structured, in three categories: market access, national treatment and additional commitments.

Part IV Progressive liberalisation: provides for progressive liberalisation so that the general level of commitments will be steadily increased in future.

Part V Institutional provisions: cover institutional and procedural matters, the creation of the Council for Trade in Services.

Part VI Final provisions: includes three annexes, which deal with particular sectors.

5.4.2 SPECIFIC COMMITMENTS

The specific commitments precisely define the conditions of access to, and operational treatment in, markets, and are inscribed in schedules attached to the Agreement. Both parts of the Agreement need to be read together to identify a member's obligations (WTO, 1998c).

There is one schedule of specific commitments for each member, attached to the general framework, except in the case of EU where there is a single schedule for the Community and its Members States.

5.5 SCOPE AND DEFINITION OF THE GATS

The GATS has an extremely wide scope of application. It applies to measures imposed by a member that affect trade in services. The term 'measure' is a broad one, and covers any action by a member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form'. Measures include those taken by 'central, regional or local governments and authorities' and by non-governmental bodies in the exercise of powers delegated by central, regional or local governmental authorities'. Also the use of the term "affecting", rather than other terms such as "governing", means that the scope of the Agreement encompasses not only measures designed to regulate trade in services directly but also any other measures that might be designed to regulate other matters but which incidentally affect the supply of a service (EC, 1996).

The WTO (1995a) states that no sector has been excluded from the coverage of the GATS, the disciplines of which apply to all services, both present and future with the exception of the air transport sector, most of which is excluded from the coverage. A part from this, the only services excluded from the coverage of the Agreement are those supplied "in the exercise of governmental authority" (WTO, 1995a, p.288). For a service to be considered, it has to be supplied neither on a commercial basis, nor in competition with one or more service suppliers. However, no member had made commitments on all services sectors.

Sauve (1995) points out that the GATS does not define "services" but does define "trade in services". The definition covers not only the cross-border supply of services but also transactions involving the cross border movement of capital and labour. This is necessary because services must very often be supplied through a commercial presence in the export market or through the presence of an individual service supplier. There are also many situations, as in tourism, where the consumer purchases the service abroad. Paragraph 2 of Article 1 defines trade in services by listing four ways in which a service can be supplied, often referred to as the four modes of supply (see figure 5.1).

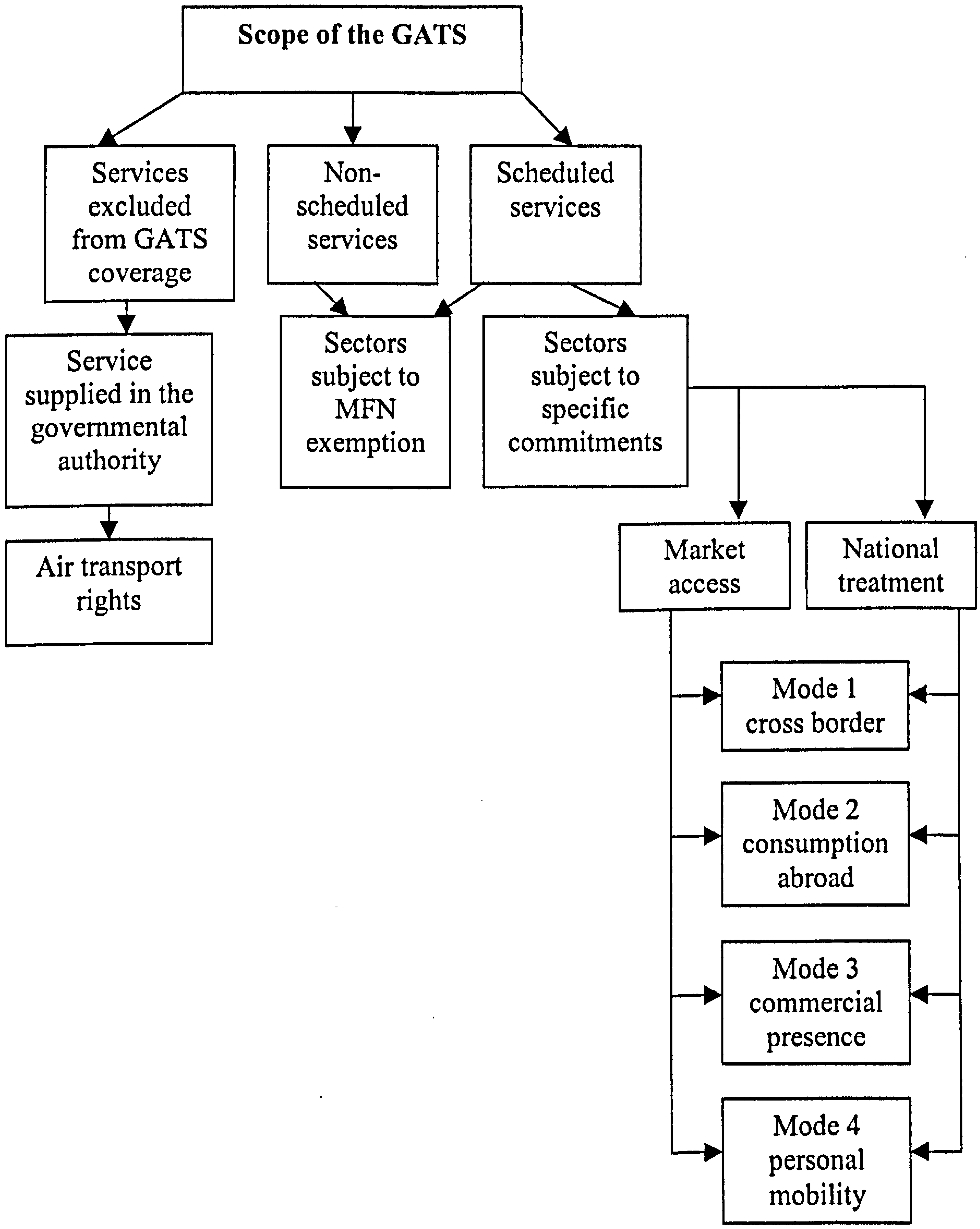


Figure 5.1: The Scope of the GATS

5.5.1 MODES OF SUPPLY

According to the UNCTAD and the World Bank (1995), the four modes of supply are defined on the basis of the origin of the service supplier and consumer, and the degree and type of territorial presence that they have at the moment the service is delivered. These modes are:

1. **Cross-border:** where the trade takes place from the territory of one member into the territory of another. Only the service itself cross the border, without the movement of persons, such as information and advice passing by means of fax or electronic mail, or cargo transportation. The service-supplier does not establish any presence in the territory of the member where the service is consumed.

2. **Consumption abroad:** this relates to services consumed by nationals of a member, in the territory of another member where the service is supplied. Essentially, the service is supplied to the consumer outside the territory of the member where the consumer resides. This is typical of tourism, and also where the property of the consumer crosses the border to be serviced abroad, such as when ships undergo repairs in another country.

3. **Commercial presence:** where the service supplier crosses the border to have a 'commercial presence' abroad through which the service is provided. This presence can take the form of any type of business or professional establishment, including incorporation, branches, representative offices, joint venture, and so on.

4. **Presence of natural person:** this mode applies to natural persons only, when they stay temporarily in the market, for the purpose of supplying services, for example the self employed, and employees of service suppliers.

The main purpose of defining the supply of a service according to these methods of supply is to facilitate the identification of regulations affecting them.

Brittan (1998) argues that meaningful market access can only be achieved if commitments are made on a combination of the relevant modes, because the relationship between the cross-border mode, commercial presence, and the presence of natural persons can be of particular importance where the service supplier has a large part to play in the actual supply of a service, such as for professional services, and the presence of company personnel.

5.6 BASIC PRINCIPLES AND OBLIGATIONS UNDER THE GATS

According to Sauve (1995), principles and obligations contained in the GATS may be categorised into two groups: general obligations which apply directly and automatically to all members, regardless of the existence of sectoral commitments; and specific commitments whose scope is limited to the sectors and activities where a member has decided to assume market access and national treatment obligations.

5.6.1 GENERAL OBLIGATIONS

5.6.1.1 Most Favoured Nation (MFN) Treatment (Article II)

The key principle of international trade, on which the GATT was based from the outset, is contained in the MFN. The GATS incorporates the same principle, with respect to any measure covered by GATS, "each member shall accord immediately and unconditionally to services and service-suppliers of any other member, treatment no less favourable than that it accords to similar services and service-suppliers of any other country" (WTO, 1995a, p.289).

This obligation is applicable to any measure affecting trade in services, and in all sectors, whether specific commitments have been made or not. UNCTAD (1999b) argues that some feared this would unfairly encourage 'free-riders', countries which accept concessions while giving nothing in return. On the other hand, WTO (1999e) points out that in practice MFN has been very effective in producing liberalisation. The principle of non-discrimination, which is embodied in MFN, must therefore remain at the core of any multilateral approach to liberalisation.

- **Exemptions to MFN**

Although MFN is a general obligation, the GATS contains an Annex allowing countries to invoke an exemption to MFN. The provision for MFN exemptions in the GATS is designed to give members some flexibility, while at the same time preserving the general principle of non-discrimination between foreigners.

According to the WTO (1995a), the Annex on Article II MFN exemptions permitted a once-only opportunity for members to take an exemption from the MFN obligation before the GATS entered into force. The measure for which the exemption was taken is described in a country's MFN exemption list, indicating to which country the more favourable treatment applies, and specifying its duration. MFN exemptions are in principle to last no longer than 10 years and are subject to negotiations in future trade liberalising rounds. A review of the conditions which created the need for the exemption takes place every five years.

The WTO (1995a) states that with the GATS in force, it is much more difficult for members to obtain an exemption because approval is necessary from three-quarters or more of members and the justification for the inconsistent treatment is subject to annual review under the WTO waiver procedure.

Countries acceding to the WTO in future will have the same opportunity as the Uruguay Round participants. They will be permitted to take exemptions from the MFN obligation under the same terms and conditions prevailing in the Uruguay Round, as part of the negotiations on their specific commitments.

According to Blackhurst et al (1995), the need for an annex on MFN exceptions largely reflected a concern on the part of some industries that MFN allowed competitors located in countries with relatively restrictive policies to benefit from their sheltered markets while enjoying a "free ride" in less restrictive export markets.

5.6.1.2 Transparency (Article III)

Like the GATT the basic principle of the GATS is transparency, which requires all relevant laws, regulations and administrative guidelines affecting trade in services to be published. Moreover, each Member shall promptly and at least annually inform the Council for Trade in Services of the introduction of any new, or any changes to existing, laws, regulations or administrative guidelines which significantly affect trade in services covered by its specific commitments under the GATS Agreement.

5.6.1.3 Other Principles

Other general obligations of the GATS deal with the following issues:

- Increasing participation of developing countries;
- Economic integration;
- Recognition of education, standards, licences, certificates etc., of other parties (allowing for harmonisation or mutual recognition arrangements of such standards, qualifications, certification systems and so on through negotiations or autonomous recognition);
- Domestic regulation (recognising of a country's right to regulate, and provisions to ensure that standards and licensing requirements do not constitute unnecessary barriers to trade or nullify commitments contained in the national schedules);
- Behaviour of public monopolies;
- Behaviour of private operators (agreement to consult with a view to removing business practices that restrict competition; requirement to provide information on business practice);
- Government procurement;
- Emergency safeguards;
- Freedom for transfers and payments for current transactions where commitments have been undertaken except if necessary to safeguard the balance of payments;
- Subsidies;
- Exceptions.

Among the most important of these Articles, especially for developing countries, are:

1. Economic Integration (Article V)

Apart from services specified in individual MFN exemption lists, the only permitted departure from Most Favoured Nation treatment under the GATS is among countries that are members of regional trading arrangements. The GATS rules on "Economic Integration", in Article V, are modelled on those in Article XXIV of the GATT.

Article V permits any WTO member to enter into an agreement to further liberalise trade in services only with the other countries that are parties to the agreement. Provided the agreement has "substantial sectoral coverage", eliminates measures that discriminate against service suppliers of other countries in the group, and prohibits new or more discriminatory measures. Recognising that action to open up services markets may well form part of a wider process of economic integration, the Article allows the liberalisation achieved to be judged in this light.

An approved agreement must be designed to help trade among its members, and must not result, for non-members, in an overall increase in the barriers they face in trading with the group in the service sectors or sub-sectors covered. If the establishment of the agreement, or its subsequent enlargement, leads to the withdrawal of commitments made to non-members, there must be negotiations to provide appropriate compensation. No compensation, on the other hand, is due from non-members for any trade benefits they may gain from the agreement.

2. Behaviour of Public Monopoly (Article VIII)

Article VIII is particularly close to GATT Article XVII on state trading. A monopoly supplier of a service must not be allowed to act inconsistently with a member's MFN obligations or its specific commitments, nor to abuse its monopoly position. If a country that has made specific commitments to allow supply of a service later grants monopoly rights for that supply, and thus negates or impairs the commitments, it will have to negotiate compensation.

3. Safeguard (Article XII)

Article XII, on restrictions to safeguard the balance of payments, sets out provisions similar to those in GATT Articles XII and XVIII: B. It permits members in serious balance-of-payments difficulties (or threatened by such difficulties) to restrict trade in services for which it has undertaken commitments. Developing countries, or countries in transition, may use such restrictions to maintain a level of reserves adequate for their development or transition programmes. However, according to the WTO (1995b), such restrictions must not discriminate among members, cause unnecessary damage to the interests of other members or be more restrictive than necessary in the circumstances, and must be temporary and phased out as the situation improves. Priority may be given to essential services, but the restrictions must not be adopted or maintained to protect a particular sector. Periodic consultations which members maintaining Article XII restrictions must undertake in the WTO are governed by rules effectively the same as those for goods, and will take place in the single WTO Balance-of-Payments Committee which examines all restrictions introduced for this purpose. Except as permitted by Article XII, a member may not restrict international transfers and payments for current transactions related to the specific services commitments it has undertaken.

On the other hand, the World Bank (1999b) states that safeguards provision in Part II of the GATS represent unfinished business, the Article provides that multilateral negotiations on the question of emergency safeguard measures, based on the principle of non-discrimination, had to be completed by the beginning of 1998 (this deadline was extended later to 15 December 2000). Until then, a member could modify or withdraw a specific commitment, in spite of the normal rule that such commitments cannot be changed for three years, if it could show the Council for Trade in Services that the action was necessary.

4. Government Procurement (Article XIII)

As under the GATT, governments' purchase of services for its own use is exempt from the basic GATS obligations. However, the same GATS provision that makes the MFN, market access and national treatment rules inapplicable to such purchases also provides that negotiations on government procurement in services shall start before the end of 1996. These negotiations are expected to lead to commitments to open up some government purchases to foreign service suppliers. Until now government procurement is exempt from the GATS disciplines.

5. Subsidies (Article XV)

According to the WTO (1999f), there are not yet any agreed trade disciplines on subsidies for services in the GATS. Article XV provides that negotiations shall take place on subsidies affecting services, and on the possible need for countervailing duties. No date is set in the Article for these negotiations. The Article recognises that subsidies can distort trade in services, but says that the negotiations should recognise the role of subsidies in developing countries. Article XV for the time being provides only that a member adversely affected by another member's subsidy may request consultations, and that the request "shall be accorded sympathetic consideration" (WTO, 1995a, p. 319).

The absence of further GATS provisions on subsidies does not mean that, under the general rules, WTO members are entirely free to use them to help only their own service suppliers. The obligation of national treatment would normally mean that certain foreign suppliers would also be entitled to receive any subsidies given to a competing domestic supplier. Many countries have in fact specifically excluded this possibility by stating in their schedules of service commitments that certain subsidies will not be available to foreign suppliers.

6. Business Practice (Article IX)

One general obligation of the GATS has no GATT counterpart. This is Article IX, which pioneers in a multilateral trade agreement in recognising that certain business practices of service suppliers may restrain competition and thereby restrict trade in services. Members agree to consult on such practices, when so requested by another member, and to exchange information with a view to eliminating them.

According to the EC (1998c), the relationship between trade and competition policies needs to be explored much more. It is a complex area, as in effect, a single entity would be needed to interpret the competition rules. In the EU, for example, this is the Court of Justice.

7. Domestic Regulation (Article VI)

The Article on domestic regulation illustrates that the GATS does not constrain parties concerning the design of their economic system or the market structure for individual services industries. As long as the requirement on non-discrimination between suppliers is satisfied, countries are free to implement policies for their service industries, and may require that certain activities be provided on an exclusive basis.

8. General Exceptions and Security Exception (Article XIV, XIV)

Article XIV of the GATS contains a number of exceptions, which have been applied to trade in goods. They allow for the enforcement of measures necessary to protect public morals and human, animal or plant life or health. In addition, a number of exceptions are provided which are specific to trade in services. These relate to the:

- Maintenance of public order;
- Prevention of deceptive and fraudulent practices;
- Effects of default in service contracts;
- The protection of individual privacy in the handling of personal data;
- Safety;
- Equitable or effective imposition or collection of direct taxes, and double taxation agreement.

The security exceptions are virtually identical with those of the GATT: nothing in the GATS requires a member to give information, or take action, against its essential security interests concerning services for a military establishment, related to fissionable or fusionable materials, or in time of war or international emergency or in pursuit of obligations under the United Nations Charter for peace and security.

5.6.2 SPECIFIC COMMITMENTS

Specific commitment obligations apply only to services that are included in the schedules of members and then only subject to whatever qualifications or conditions are listed.

5.6.2.1 Market Access

Market access relates to the four modes of supply, and provides that a member "shall accord services and services suppliers of any other member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specified in its schedule" (WTO, 1995a, p. 300). This prohibits the maintenance of other obstacles to access not elsewhere authorised by the GATS, and ensures that the same conditions apply to all services and service suppliers (Hoekmon, 1995).

The concepts of market access and progressive liberalisation had to be put into the GATS due to the complex regulatory situations applying to services sectors. This represents a major departure compared with trade in goods, where tariffs are used for protection, and liberalisation is achieved through tariff reductions. It should be noted, however, that neither concept is explicitly defined in the GATS.

Braga (1995) states that unlike the GATT for goods, there is no general obligation in the GATS to grant a service supplier the right to enter the market to do business in the preferred manner. Market access has to be negotiated by sector and mode of supply. A member is only obliged to grant market access to the extent it has provided for in its schedule of commitments.

In principle six types of market access restrictions are prohibited (GATT 1994):

1. The value of service operations in terms of transactions or assets;
2. The number of service suppliers allowed;
3. The total quantity of service output;
4. The number of natural persons that may be employed;
5. The participation of foreign capital in terms of a maximum percentage limit of foreign shareholding or the absolute value of foreign investment ;
6. The type of legal entity through which a service supplier is permitted to supply a service (e.g., branches vs. subsidiaries for banking).

Most of these measures are non-discriminatory in nature as they can also apply to domestic service suppliers, but all act to control the presence of a foreign supplier in the market by means of quantitative restrictions.

A country is deemed to have granted full market access if it has not negotiated the right to impose any of the above limitations. It can then inscribe 'none' in its schedule of commitments in the market access column, indicating that there are no limitations.

If a particular form of market access, be it limited or unlimited, is inscribed in a schedule, it has to be granted on a MFN basis. A market access commitments in effect entails a standstill obligation, as a country is no longer entitled to change its regulations in a way that would make access impossible, or more restrictive or difficult in any way.

According to Braga (1995), any capital movements in connection with the market access permitted have also to be allowed, but the obligation to admit capital exists only where a specific commitment has been made. In the case of the cross-border mode of supply, capital movements, whether into or out of the member's territory, must be allowed if they are an essential part of the service provided, such as payment of an insurance claim. In the case of supply through commercial presence, related capital outflows do not have to be permitted.

Stephenson (1999) states that the introduction of a market access commitment reflects one of the distinguishing characteristics of service markets: the fact that their contestability is frequently restricted by non-discriminatory measures. The market access article explicitly covers six such measures that were felt to be of access obligation overlaps with the national treatment requirement, as prohibited measures may be discriminatory as well as non-discriminatory. The overlap creates potential for confusion and disputes. Because national treatment and market access are not general obligations, in the GATS context the schedules of commitments of members are very important in determining the extent of the market access opportunities resulting from the Agreement.

5.6.2.2 National Treatment

According to the IMF (1997b), in contrast to the WTO and the GATT, the national treatment principle in the GATS is not a general obligation; it applies to the services that are listed in the schedule of the specific commitments of a country. National treatment is defined as "each member shall accord to services and service-suppliers of any other member, in respect of all measures affecting the supply of services, treatment no less favourable than that which it accords to its own like services and service suppliers" (WTO, 1995a, p. 301). However, such treatment may or may not be identical to that applying to domestic firms, in recognition of worsen the conditions of competition for foreign-based firms (e.g. a requirement for insurance firms that reserves be held locally).

5.7 SCHEDULING THE SPECIFIC COMMITMENTS

5.7.1 THE NATURE OF THE COMMITMENTS

The core of the GATS is its specific commitments (World Bank, 1995b). Members choose to pursue a "hybrid" of a positive and negative list approach to scheduling specific commitments. It is a positive list with respect to determining sectoral coverage of market access and national treatment commitments; a negative list with regard to the maintenance of measures that violate either national treatment or the market access disciplines.

According to the WTO (1996b), Article XX of the GATS sets out the basic rules regarding the schedules of specific commitments and defines their contents. Each WTO member is required to have a Schedule of Specific Commitments, a document, which identifies the service sectors, sub-sectors, or activities to which it will apply the market access and national treatment obligations. In addition, it must indicate any limitations, which it intends to maintain for market access and national treatment for those sectors or activities. The necessary indications must be entered with respect to each of the four different modes of services supply.

Every such indication in a schedule is a binding commitment to allow supply of services on the terms and condition specified, and not to impose any new measures that would restrict entry into the market or the operation of the service.

The commitments inscribed in a country's schedule attached to the GATS are legally enforceable. They follow a common format and a standard terminology, which are intended to facilitate comparative analysis.

Members are under no formal obligation to undertake any given level of specific commitments (Brittan, 1998). The only obligation is that a member must have a schedule of specific commitments, however minimal the commitments contained in it are. Each member is required to indicate in its schedule of specific commitments the date of entry into force. In the absence of an indication, the commitments took effect at the same date as the GATS for the member concerned. Commitments resulting from extended negotiations apply from the date at which the relevant protocol enters into force for a member.

The WTO (1996b) states that, pursuant to Article XXI, specific commitments may be modified or withdrawn not earlier than three years after their entry into force. However, countries, which may be affected by such modifications, may request the modifying member to negotiate compensatory adjustments. Any such adjustments are to be granted on MFN basis. In some circumstances, Article X has temporarily reduced this period to one year. The modifying member must, however, show cause to the Council on Trade in Services that the modification or withdrawal cannot await the lapse of the three-year period provided by the Article XXI.

In order to determine the real level of market access represented by a given schedule, careful reading of the sector covered is necessary, including the description of the coverage, the limitations and conditions pertaining to market access, and national treatment for each mode of supply. To a very large extent, the impact of the GATS depends on the specific commitments made by members.

5.7.1.1 Overview of the Schedules of Commitments

It is not possible to quantify the value or the potential trade effects of commitments in services in the same way as for tariff bindings (WTO, 1998e). In the first place, in services there is no equivalent to customs duties; protection against imports, where it exists, typically takes the form of discriminatory regulations or barriers against the practices of services by foreigners, and the effect of such measures or their removal cannot easily be quantified. Secondly, the comprehensive data needed to estimate imports of particular services under the different modes of supply, or even in aggregate terms, do not exist, nor is there an equivalent in services to the internationally agreed harmonised system nomenclature for tariffs on goods to categories commitments. Quantitative presentation of the commitments in GATS schedules is therefore much more difficult than for tariff commitments.

Hoekman (1999) states that it is possible, nevertheless, to present in tabular form several aspects of the commitments. The tabulations are recognised on the basis of the list of 161 service activities that participants have generally used to describe and categorise their commitments. In interpreting the tabulations on services, two points must be kept in mind. First, there is a great deal of variation between the 161 service activities in terms of employment, production and trade; the figures in the service tables are not "trade-weighted". Secondly, the figures showing levels of commitments in particular country groups mask significant variations in the sectoral coverage of commitments as between individual countries in the group.

Although there is great variation in the number of countries offering commitments on different services, there are no actors, which have been excluded from the scope of commitments. The majority of the commitments bind the existing level of access while others incorporate and bind liberalisation of previously existing restrictions.

5.7.2 SCHEDULES OF SPECIFIC COMMITMENTS

According to the GATT (1994), the schedules of specific commitments are split into two sections: first, "horizontal" commitments applying to all sectors included in the schedule, such as a restriction on the purchase of land by foreigners; and second, "sector-specific" commitments applying to particular services or activities.

5.7.2.1 Horizontal Commitments

Hoekman (1995) states that the horizontal section contains limitations, which apply to all sectors included in the schedule. These often refer to particular modes of supply, notably commercial presence and movement of natural persons. Most schedules do not contain horizontal limitations applying to modes of supply 1 and 2 (cross border and consumption abroad). The only purpose of having a section for horizontal commitments is to avoid repeating the same entry in relation to each sector contained in the schedule. Any evaluation of sector-specific commitments must therefore take into account the horizontal entries.

5.7.2.2 Commitments Relating to Sectors and Sub-Sectors

The layout has four columns (see table 5.1). A row is formed by a sector line for entry, reading across the columns, with the four modes of supply shown. The columns include:

1. Sector or Sub-Sector Column

This column contains a clear definition of the sector, sub-sector or activity that is the subject of the specific commitments.

2. Market Access Column

When a member undertakes a commitment in a sector or sub-sector, it must indicate for each mode of supply what limitations, if any, it maintains on market access. Article XVI: 2 of the GATS (market access) lists six categories of restrictions which may not be adopted or maintained unless they are specified in the schedule. All scheduled limitations on market access therefore must fall into one of these categories. They comprise four types of quantitative restrictions as well as limitations on foreign equity participation and on the types of legal entity permitted.

3. National Treatment Column

A member wishing to maintain any limitations on national treatment, that is any measures, which result in less-favourable treatment of foreign services or service suppliers, must indicate these limitations in this column of its schedule.

4. Additional Commitments Column

Entries in this column are not obligatory but a member may decide in a given sector to make additional commitments, relating to measures other than those subject to scheduling under the market access and national treatment columns. Such undertakings relate, for example, to qualifications, technical standards, licensing requirements or procedures, and other domestic regulations.

Table 5.1: Illustrative Schedule of Specific Commitments

Country Name - Schedule of Specific Commitments

Modes of supply:

1) Cross-border supply
2) Consumption abroad
3) Commercial presence
4) Presence of natural persons

Sector or sub-sector	Limitation on market access	Limitation on national treatment	Additional commitments
I. Horizontal commitments			
	3) None 4) Bound	3) None 4) Unbound*	
II. Sector specific commitments			
Sector	1) None 2) Unbound 3) 4)	1) None 2) Unbound 3) 4)	

Source: WTO (1998e)

5.7.2.3 How Commitments Are Recorded In Schedules

In essence, the entries which constitute a legally binding commitment in a member schedule indicate the presence or absence of limitations on market access and national treatment in relation to each of the four modes of supply for a listed sector, sub-sector or activity (Low and Mattoo, 1999). In the following cases, the entries use a uniform terminology:

None (full commitments): where there are no limitations on market access or national treatment in a given sector and mode of supply, the entry reads NONE. However, it should be noted that when the term NONE is used there may be relevant horizontal limitations in the first part of the schedule.

Unbound (no commitments): All commitments in a schedule are bound unless otherwise specified. In such a case where a member wishes to remain free in a given sector and mode of supply to introduce or maintain measures inconsistent with market access or national treatment, the member has entered in the appropriate space the term UNBOUND, only relevant for use where a commitment has been made in a sector with respect to at least one mode of supply. Where all modes are unbound, and no additional commitments have been undertaken in the sector, then the sector will not appear in the schedule at all.

Unbound* (no commitments technically feasible): It may not be technically possible or feasible for some services to be supplied through a certain mode of supply (such as a cross-border sit-down restaurant service). In such cases the term UNBOUND* has been used, usually in conjunction with an explanatory footnote stating "Unbound due to lack of technical feasibility".

5.7.2.4 List of MFN Exemptions

The MFN is a general obligation, applying to all measures affecting all trade in services. According to Lloyd (1999b), however, it has been agreed that particular measures inconsistent with the MFN obligation can be maintained. Such measures must have been specified in a list of MFN exemptions submitted by the end of the Uruguay Round or by the conclusion of external negotiations on certain sectors for which the delayed submission of related exceptions was expressly authorised.

The MFN lists are mostly self-explanatory. In order to be exempted from the MFN obligation, each member is required to provide the following information for each exemption:

- A description of the sector in which the exemption applies;
- A description of the measure, indicating why it is inconsistent with the MFN obligation, and explaining the preferential treatment granted under the specific measure;
- The country or countries to which the measure applies;
- The intended duration of the exemption;

- The conditions justifying the need for the exemption.

5.8 SECTORAL COVERAGE

The GATS applies to all services sectors, and its Annexes, and other attachments, set out specific rules applying to certain sectors (Whichard, 1999). These annexes form an integral part of the GATS, and their provisions complement the general rules.

In order to help countries negotiate and schedule their specific commitments, the GATT secretariat issued a classification list of services sectors. It gave a good indication of what is at present considered to be a service. It is not obligatory for countries to use this list. A classification for financial services has been incorporated in the Annex on financial services.

Hoekman and Messerlin (1999) state that the list is based on the Central Product Classification (CPC) of the United Nations which gives a detailed explanation of the service activities covered by each listed sector or sub-sector, with the exception of communication and financial services, where a GATS-specific breakdown of activities was deemed necessary.

The list contains 12 broad sectors each divided into several sub-sectors, at the most detailed level of the GATS classification there are 155 non-overlapping service sectors and four modes of supply, which implies a maximum of 620 possible commitments (UNCTAD, 1998g). As commitments apply to national treatment and market access separately, there are 1,240 data cells for each member. The 12 service sectors are as follow:

1. Business services, including professional services;
2. Communication services, including telecommunications and audio-visual services;
3. Construction and related engineering services;
4. Distribution services;
5. Educational services;

6. Environmental services;
7. Financial services, including insurance and banking;
8. Health-related and social services;
9. Tourism and travel-related services;
10. Recreational, cultural and sporting services;
11. Transport services, including maritime, waterways, air and road transport services;
12. Other services not included.

Each sector contained in the secretariat list is annotated with the appropriate Central Product Classification (CPC) numbers. Snape and Bosworth (1996) argue that much multilateral work remains to arrive at a more operational list and at descriptions which better reflect economic realities and business interests.

According to Mattoo (1997), since countries are free to decide in which sectors they will offer market access, the number of sectors covered by national schedules varies widely. Simply to count the number of countries which have undertaken commitments in a particular sector or sub-sector gives no indication of the level of liberalisation achieved, since this depends on the scope of the limitations to which the commitments is subject. But such a count does indicate the level of interest of the members in any given sector.

The sector in which most commitments were undertaken is tourism and travel-related services: 97 members made commitments (counting the EU as one). The main activities covered relate to the core tourism services provided by hotels and restaurants, travel agents and other operators as well as by tourism transport companies. Stephenson (1999) states that this reflects the tremendous importance of tourism and travel for a large number of countries. Certain countries have covered only this sector in their schedule of specific commitments as they considered that tourism was the only sector in which their economy would benefit from international trade in services, or in which they thought they had a competitive advantage. The large number of commitments by developing countries reflects the desire of governments to realise the potential of the tourism sector to generate domestic employment and foreign exchange revenue in developing countries

Seventy-four members have made commitments in communication services. Financial services, have also been covered in the schedule of specific commitments by a large number (82 members). In this sector, however, participating countries agreed to continue negotiations on the basis of the existing commitments with a view to achieving further liberalisation. Business services come next with 81 members (see figure 5.2).

Figure 5.2 shows also that sixty-four countries made commitments in transport services, which according to Christopher (1999), apply to three activities: aircraft repair and maintenance services, selling and marketing of air transport services and computer reservation system (CRS). It was agreed that commitments would not be made in relation to traffic rights and the supply of services directly related to the exercise of traffic rights, matters which are currently regulated through a network of largely bilateral agreements. Coverage of the air transport sector is very limited, given the exclusion of landing rights and many other aspects of air transport from the scope of the GATS. The relatively limited number of commitments in the health, education and environmental sectors is largely a reflection of the fact that in many countries these services are provided by government, and that competitive commercial provision is not widespread (WTO, 1999a).

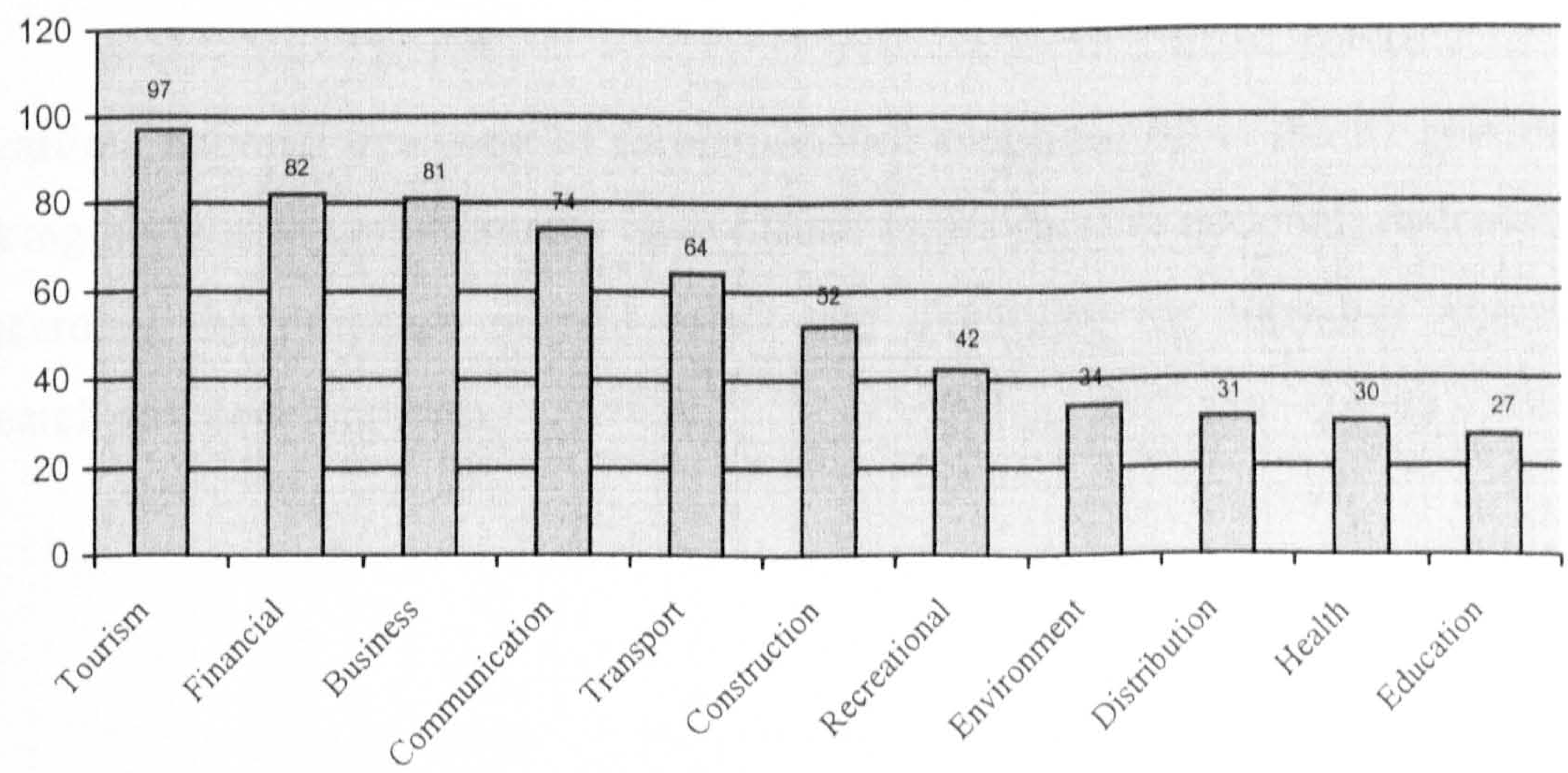


Figure 5.2: Number of Countries Undertaken Commitments in Each Sector

Source: WTO (1999j)

5.8.1 LIMITATIONS ON SPECIFIC COMMITMENTS

The level of access provided by a commitment depends on the charter of the existing regulatory regime and the nature of the limitations, if any, to which the commitments are subject, which may be horizontal (covering all sectors) or sector specific.

5.8.1.1 Horizontal Limitations

Most schedules do not contain horizontal limitations applying to modes of supply 1 (cross border) and 2 (consumption abroad). In contrast, most schedules contain horizontal limitations on the supply of services through commercial presence and on the presence of natural persons.

With respect to commercial presence, 87 governments have entered horizontal commitments in their schedules (see table 5.2). Of these, 31 entered no horizontal limitations on market access through commercial presence. 55 have entered such limitations, 10 authorising foreign investment on the basis of an "economic needs test", 25 imposing ceilings on equity participation by foreign investors, and the remaining 20 requiring establishment to take the form of a specified legal entity, for example, by requiring the establishment of a subsidiary. One country has offered no binding regarding market access through commercial presence.

Regarding national treatment of foreign service suppliers, 68 of the 87 governments making horizontal commitments have placed limitations on national treatment, most concerning the purchase of real estate and eligibility for subsidies (mainly for research and development).

Table 5.2: Horizontal Commitments on Commercial Presence

Market access	Number of schedules	National treatment	Number of schedules
Total	**87**	**Total**	**87**
Unbound	**1**	**Unbound**	**1**
No limitation	**31**	**No limitations**	**18**
With limitation	**55**	**With limitations**	**68**
• Authorisation subject to an economic needs test	10	• Taxation	11
		• Eligibility for subsidies	28
• Legal entity	25	• Purchase of real estate	41
• Ceilings on foreign equity Participation	20	• Nationality requirements for directors	8
		• Access to local finance	6

Source: WTO (1998e)

With respect to the supply of services through the presence of the natural persons, the Mattoo (2000b) states that most countries have specified their commitments on the market access and national treatment for this mode of supply in the horizontal section of their schedule. The entries differ considerably in detail and terminology but fall into three categories:

- Quantitative market access limitations stipulate limitations on the total number of foreign natural persons who can supply services, expressed either in the form of a quota on the percentage of a foreign personnel employed requirement of an economic needs (or labour market) test;

- Bound commitments for certain types of personnel whereby countries have scheduled measures affecting the entry and temporary stay of some categories of natural person supplying services while leaving other categories unbound. The main categories are business visitors, intra-corporate transferees and professionals who are employed on a contract basis;

- There are also horizontal commitments where the relevant national authorities, either the immigration or labour ministries, are given broad discretionary authority in granting permission for temporary entry and stay of foreign natural persons supplying services.

Table 5.3 shows that in 70 cases, governments offer bindings only for the entry of intra- corporate transferees, often stipulating that these should be senior personnel such as executives, managers or specialists. In 25 of these cases, the admission of intra-corporate transferees is nevertheless subject to a quota or an economic needs test. 50 schedules contain no limitations on national treatment of natural persons, but in 35 cases there is differential treatment, such as exclusion from access to government subsides or purchase of real estate.

Table 5.3: Horizontal Commitments on the Presence of Natural Persons

Market access	Number of schedules	**National treatment**	Number of schedules
Total	**87**	**Total**	**87**
Entry of natural person is subject to: • An economic needs • A quota	 14 3	**Unbound**	**2**
Binding for intra-corporate Transferees of which: • Only for senior personnel • Subject to an economic needs test • Subject to quota	**70** 66 11 14	**No limitations**	**50**
		With limitations, relating to: • Taxation • Eligibility for subsidies • Purchase of real estate Other	**35** 6 23 8 2

Source: WTO (1998e)

5.8.1.2 Sector Specific Limitation

Information on sector-specific limitations on market access and national treatment is organised according to the sector to which they belong (see table 5.4) (Whichard, 1999). The number of specific limitations affecting cross border supply and consumption abroad is low for most service sectors. Where the unbound percentage is high for cross-border supply, as in construction, environmental and health services, this is normally because cross border supply of these services is not technically feasible. In the case of supply through commercial presence and the presence of natural persons, the high proportion of commitments without limitations must be seen in relation to the fact that most limitations on these modes are contained in the horizontal section of the schedules.

Table 5.4: Nature of Commitments by Service Sector (1998)

(Percentage in each category)

Sector	Cross-border			Consumption abroad			Commercial presence			Natural persons		
	No limits	Limits	Unbound	No limits	Limits	Unbound	No limits	Limits	Unbound	No limits	Limits	Unbound
Business	72	3	25	88	1	11	86	11	4	86	8	7
Communication	73	10	16	88	1	11	86	11	4	86	8	7
Construction	17	1	82	83	0	17	80	15	5	91	6	3
Distribution	69	3	28	93	0	7	87	12	1	92	5	3
Education	81	9	10	92	3	6	77	18	5	90	6	5
Environment	20	0	80	96	0	4	96	4	0	94	4	2
Financial	51	19	30	57	17	26	39	56	5	75	15	10
Health	20	0	80	89	2	9	76	16	8	89	6	6
Tourism	51	4	45	88	1	11	78	17	5	82	8	10
Recreation	68	0	31	94	1	5	86	9	5	89	5	6
Transport	48	3	49	94	0	5	74	13	13	91	3	6

Note: Percentage may not add up to 100 due to rounding;

Limitations include both market access and national treatment;

Unbound means that a mode of supply is excluded;

No limits, indicates the absence of sector-specific limitations.

Source: WTO (1998e)

The commitments of developed countries cover nearly all sectors although there are a few exceptions such as postal services, basic telecommunications and maritime transport and audio-visual services (Snape and Bosworth, 1996).

The need to liberalise the services market in developing countries is highlighted against the limited number of commitments undertaken by these countries in the Uruguay Round in the services area. Developing countries included fewer sectors in their schedules of commitments than did developed countries, and also tabled fewer measures with respect to these sectors. Many of the commitments were qualified through reservations and exemptions with respect to market access or national treatment. Developing countries scheduled only 17.2 percent of maximum possible commitments on services, as compared with 53.8 percent for industrialised countries, as shown in table 5.5, and the percentage was even lower than this average for Latin America, Africa and the Middle East.

Table 5.5: Commitments on Services at end of Uruguay Round

	Number of countries	Number of services commitments	Commitments as share of maximum possible (%)
Industrial countries	25	2,423	53.8
Developing countries	81	2,159	17.2
Latin America	-	738	15.3
Africa	-	396	9.8
Middle East	-	106	16.5
Asia	-	796	26.0

Source: GATT (1994)

In many cases scheduled sectors continue to be subject to measures that violate national treatment or limit market access. Only 25 percent of the worldwide services was scheduled by high-income countries without listing any exceptions to national treatment or market access obligations. For developing countries as a group, the figure is 7 percent. Hoekman (1999) states that much remains to be done.

Sauve (2000) argues that developing countries made the greatest number of commitments to open their services markets to foreign suppliers in the areas of hotels and restaurants (68.3 percent), computer-related services (21.4 percent) and financial services (19.5 percent). However, there is almost a total absence of commitments in the sectors of construction and engineering, distribution services, educational services, environmental services, health and social services, and recreational and cultural services.

5.8.2 WHAT HAS NOT YET BEEN COVERED BY THE GATS

According to the WTO (1999e), GATS is not a free trade agreement, but a tool leading to trade in services without discrimination or other non-tariff barriers. It does not mean immediate and full liberalisation, but a beginning of the liberalisation process. Recognising this fact, the GATS does not intervene in the economic policies and regulations of its member countries, unless such policies are applied unequally to domestic and foreign services suppliers.

In addition GATS, does not deal with frontier formalities which affect travellers, such as visas, passports, customs duties, exit taxes, or taxes on tourism services. Nor does it apply to foreign exchange allowances or restrictions affecting international travellers.

Whichard (1999) states that although the scope of the GATS is very wide, dealing with all measures affecting trade in services, some matters of importance to service-suppliers lie outside the GATS disciplines:

- Immigration rules;
- Services supplied under government authority;
- Fiscal policy and taxation measures, there are disciplines to ensure that taxation is applied on a Most Favoured Nation (MFN) basis, and is not unduly distortive;
- Customs systems, the import of equipment necessary for the supply of a service;
- Certain aspects of investor protection, concerning the movement of capital;
- Exchange-rate management, the WTO will work with the IMF and World Bank to create conditions of greater economic stability, including exchange-rate management (e.g. by setting interest rates);
- Privatisation forms of ownership as such are not addressed, but there are disciplines for state-owned trading entities and monopolies.

5.9 GATS AND TOURISM

The travel and tourism industry in many countries has long supported the idea of a services agreements which is effective in terms of opening up new trade and investment opportunities, eliminating distortive practices that restrict competition and guaranteeing long term stability in market access and regulatory fairness (Kakabadse, 1994). The answer to how effective the negotiations have been lies in each participating country's schedule of legally binding liberalisation commitments.

5.9.1 DESCRIPTION OF THE SECTOR

The WTO (1998h) points out that during the Uruguay Round, a working group in tourism services was formed, and a number of meetings were held. At the request of the Working Group, the Secretariat circulated two documents. The first document was entitled "Trade in Tourism Services", dated 4 July 1990. The paper provided an overview of tourism-related activities; forms of trade in tourism services; motivations and objectives for regulation; and existing regulations. Some basic statistics were presented, as well as background information on the World Tourism Organisation. A second is a document entitled "Classification of Tourism-Related Services", dated 23 October 1990. The paper included an illustrative list of core tourism activities, based on the draft "Standard International Classification of Tourism Activities" (SICTA) of the World Tourism Organisation. The SICTA identified approximately 70 specific activities related to supplying tourism services; in addition, another 70 activities at least partially concerned the supply of tourism services. An attribution of SICTA activities to GATS categories has been made by the World Tourism Organisation.

According to the WTO (1998g), instead of "tourism services" the GATS classification introduces the term "Tourism and Travel Related Services". Such wording corresponds partly to the United Nations/WTO definition of tourism which is described as comprising "the activities of persons travelling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business and other purpose" (WTO, 1998g, p. 2).

The WTO (1998h) goes on to say that Tourism and Travel Related Services (TTRS), category 9 of the Services Sectoral Classification List of GATS, is distinctly limited in scope. The category is divided into four sub-sectors, the first three of which have associated listing under the United Nations' "Provisional Central Product Classification" (CPC). These sub-sectors are as follows:

A. Hotels and restaurants (including catering);
B. Travel agencies and tour operators services;

C. Tourist guides services;
D. Other.

No further sub-classifications are currently provided for under Tourism and Travel-Related Services. Tourism activities are part of more general services activities, most notably many transport services, but also include certain business services; distribution services; and recreational, cultural and sporting services, and have typically been placed within those general services categories.

Under the Provisional Central Product Classification itself (CPC), Hotels and other lodging services are divided into:

- Hotel lodging services;
- Motel lodging services;
- Other lodging services. This includes, holiday camp services, youth hostels, etc.

Food serving services are divided into:

- Full restaurant services;
- Self-service facilities;
- Catering services;
- Other.

The catering sub-sector classification under CPC (Beverage serving services for consumption on the premises) is composed of:

- Services without entertainment;
- Services with entertainment.

Travel agencies and tour operator services and tourist guides services are not further subdivided. The term "other" might suggest the list could be completed by any other remaining service if related to tourism and travel. However, it is not the case since many such services are already covered by other sectors of the same classification. It is then important to be prepared to look across all these sectors to identify a comprehensive tourism content (WTO, 1998h).

International tourism is defined by the World Tourism Organisation as occurring when a traveller crosses an international border (WTO, 1998h). The GATS definition of tourism in general, as reflected in the Tourism and Travel Related Services, leaves out many services activities, such as computer reservation systems, transport, hotel construction, and car rentals, which are regarded by the World Tourism Organisation as key tourism-related industries. The World Tourism Organisation has stated that it is not satisfied with the current GATS definition, and would like to have it revised in the next round of service negotiations.

5.10 OVERVIEW OF COMMITMENTS IN TTRS

The overview of commitments in Tourism and Travel Related Services relates to an analysis of the extent of liberalisation in TTRS in the GATS framework and is based on the study of countries' schedules of commitments in Travel and Tourism Related services as well as their schedules of horizontal commitments. The study of the countries' schedules focuses on the modes of supply.

As of September 1998, 112 WTO Members have made commitments in Tourism and Travel-Related Services (TTRS) under the GATS. This number is greater than for any other sector, and indicates the desire of most Members to expand their tourism sectors and to increase inward foreign direct investment (FDI) as part of efforts to promote economic growth. In the view of the World Tourism Organisation, the tourism sector was already highly liberalised before the Uruguay Round negotiations; few major obstacles remain (WTO, 1999g)

Diaz (1995) argues that the tourism sector, as defined in the schedules of concessions incorporated into GATS, is subject to a high degree of liberalisation, particularly under the commercial-presence and consumption abroad modes of supply. Still, the coming round of multilateral negotiations will provide an opportunity for the refinement of the offers, the expansion of market access under other modes of supply and the incorporation of the necessary regulatory commitments.

Furthermore, Edgell (1999) suggests that the trend towards overall trade liberalisation, including the liberalisation of investment regimes, has been followed by increasing restrictions on the movement of people. The GATS schedules on tourism services under GATS should aim at a comprehensive liberalisation of all aspects of tourism services. This could be incorporated into a sectoral annex, which would also provide disciplines on anti-competitive practices (access to information, fair and transparent, and security conditions for service contracts).

The number of commitments made by members varies widely by sub-sector (World Bank, 1999d). Hotels and restaurants (sub-sector A) shows the greatest number, with 112 Members (i.e. all) making commitments, followed in order by sub-sector B, travel agencies and tour operators services with 89, sub-sector C, tourist guides services, with 54, and sub-sector D, other, with only 13 commitments. Under "other", a number of Members have given no description in their GATS schedule of what is included; other Members have listed specific activities, in one case including transport-related commitments.

Of the 112, 10 have made commitments in all four sub-sectors; 45 in three sub-sectors, 36 in two sub-sectors and 21 in only the first sub-sector. In other words, nearly half of the Members making commitments have done so in three or more sub-sectors.

Mattoo (1997) states that with regard to the level of market access and national treatment provided within Member schedules, commitments by mode of supply also vary widely for the tourism sector as a whole (see table 5.6 and 5.7). The percentage of Members placing no restriction on market access (i.e. a "None" entry in their schedule for all sub-sectors where commitments are made) is highest for consumption abroad (at 49 percent), and lowest for the presence of natural persons (at 1 percent). On contrast, many countries attempt to contain many commitments on presence of natural person (94%) and on commercial presence (77%).

With respect to national treatment, the pattern is similar, with the percentage of Members having no restrictions on their commitments at, 52 percent for consumption abroad and 11 percent for the presence of natural persons. The number of countries attempt to contain many commitments is the highest for presence of natural person (80%) and for commercial presence (54%).

Regarding "Unbound" modes of supply, i.e. those for which no commitments are made, the level in respect to both market access and national treatment is highest for cross-border supply, due primarily to a lack of technical feasibility, at 27 percent and 24 percent, respectively.

Table 5.6: Number of Countries by Mode of Supply-TTRS

Mode of supply	Market access			National Treatment		
	Full	**Part**	**No**	**Full**	**Part**	**No**
Cross Border	33	49	30	37	48	27
Consumption Abroad	55	47	10	58	42	12
Commercial Presence	25	86	1	49	61	2
Presence of natural person	1	105	6	12	90	10

Source: World Trade Organisation, Council for Trade in Services (1998g)

Table 5.7: Percentage of Countries by Mode of Supply-TTRS

Mode of supply	Market access			National Treatment		
	Full	**Part**	**No**	**Full**	**Part**	**No**
Cross Border	29%	44%	27%	33%	43%	24%
Consumption abroad	49%	42%	9%	52%	38%	11%
Commercial Presence	22%	77%	1%	44%	54%	2%
Presence of natural person	1%	94%	5%	11%	80%	9%

Source: World Trade Organisation, Council for Trade in Services (1998g)

5.10.1 ANALYSIS OF THE COMMITMENTS BY SUB-SECTOR

Table 5.8 presents an analysis by individual sub-sector, showing a similar pattern to that for the tourism sector as a whole.

Table 5.8: Percentage of Countries by Sector and Mode of Supply- Tourism and Travel Related Services

Market Access	Cross border			Consumption abroad			Commercial presence			Personal mobility		
	Full	Part	No	Full	Part	No	Full	Part	No	Full	Part	No
09.A.	31%	23%	46%	54%	37%	9%	27%	72%	1%	3%	91%	6%
09.B.	49%	19%	31%	56%	20%	15%	27%	67%	6%	1%	88%	11%
09.C.	56%	7%	37%	78%	13%	9%	41%	54%	6%	0%	85%	15%
09.D.	38%	31%	31%	38%	54%	8%	23%	69%	8%	0%	92%	8%

National Treatment	Cross border			Consumption abroad			Commercial presence			Personal mobility		
	Full	Part	No	Full	Part	No	Full	Part	No	Full	Part	No
09.A.	37%	21%	42%	58%	30%	12%	51%	46%	3%	11%	79%	10%
09.B.	55%	15%	30%	70%	13%	17%	64%	27%	9%	17%	69%	15%
09.C.	59%	4%	37%	85%	4%	11%	76%	15%	9%	13%	67%	20%
O9.D.	54%	23%	23%	62%	38%	0%	54%	46%	0%	23%	69%	8%

Note: Percentages may not add up to 100 due to rounding. Basis of total is listed sectors.

Source: World Trade Organisation, Council for Trade in Services (1998).

5.10.1.1 Hotels and Restaurant Sub-Sector

According to UNCTAD (1998g), all of the member countries presented commitments in hotels and restaurant sub-sector. Attention must also be drawn to the fact that no MFN exemption was filed by any country, thus further strengthening the liberalisation commitments. On the other hand, the numbers of countries, which have submitted commitments in the restaurant sector, is relatively low. 13% of countries which, presented commitments in TTRS did not offer any in restaurants, most of them being in Caribbean or Asia (India, Indonesia). Less than half of the 112 countries (44%) either specifically mentioned catering as part of restaurant services or signalled it out for separate commitments.

Limam (1994) states that cross-border and consumption abroad modes of supply, hotels and restaurants services are generally supplied in the recipient country through locally established facilities. The cross-border mode of supply is therefore not usually appropriate for hotels and probably explains why most countries presented no restrictions or declared "unbound*" due to lack of technical feasibility with respect to both market access and national treatment. For market access, the percentage of countries placed no restriction and declared unbound* on cross border is 31% and 46% respectively which form together 77%. For national treatment the pattern was similar at 37% and 42% respectively, in total, 79%. A few South American and East Asian countries stated "unbound", and one can ask whether it is safe to assume that they meant the same as "unbound due to lack of technical feasibility".

The WTO (1998g) argues that, by the same token, a hotel chain investing in a country will obviously be interested in offering its services to a country's incoming tourists. Whether that country's residents face restrictions in travel abroad, and thus affect another country's hotel industry, may be regarded as of little concern to the former. This explains why most countries presented no restriction on consumption abroad mode of supply at 54% and 58% with respect to market access and national treatment respectively. The exception being for Latin American countries (Brazil, Cuba, Dominican Republic, Peru), and another four South Asian States and Turkey which informs in a foot note that it levies a departure fee on its citizens travelling abroad. All 9 countries presented an "unbound" commitment.

Regarding commercial presence, Hirst (1994) states that due to the nature of the accommodation sector, commercial presence is the mode of supply which faces most restrictions at 72% and 46% with respect to market access and national treatment respectively. African and American countries (including Canada) exclusively relied on licensing requirements. Some European countries presented restriction based on the need to protect the environment and artistic or historic (EAH) areas, while others used the "economic needs test" as a barrier. Asian countries seemed to have a preference for capital-related measures with five countries restricting the amount of foreign investment in the hotel industry through foreign equity ceiling. Most of these measures affect the market access principle; fewer countries deny national treatment to foreign enterprises using residency/citizenship requirements or the obligation for foreign hotel chains to train local personnel. Most of the countries that imposed restrictions on national treatment are developing ones.

With respect to the presence of natural persons, Houde (1994) states that the hotel industry, like most the services in the tourism sector, is labour intensive and therefore relies on its workforce and the possibility to move it freely from one site of operation to another.

Considering this fact, the presence of natural person modes of supply is the least liberalised, since most countries restrict the movement of hotel staff at 91% and 79% with respect to market access and national treatment respectively. Developing and developed counties alike impose restrictions on the entry of foreign workers committing themselves only to letting in intra-corporate transferees, especially managers, expert/specialists, and business visitors whose aim is to contribute to the commercial presence of a hotel facility. In most countries, lower-level employees are not allowed in, top employees are allowed under certain carefully designed conditions. The majority of these limitations are not specific to the hotel industry, not even to the tourism sector, but apply across the border to all industries (horizontal commitments) (see table 5.9).

Table 5.9: Percentage of Commitments by Mode of Supply: Hotel and Restaurant Services

Barriers to trade	Market access		National treatment	
	Full	Part	Full	Part
Cross border • Lack of technical feasibility	31%	46%	37%	42%
Consumption abroad • Hard currency regulation	54%	37%	58%	30%
Commercial presence • Licensing, non-automatic approval, registration, permit. • Economic needs test-9 countries. On the type of entry: joint ventures, incorporation, branches. • Requirement for foreign capital equity ranging from 30% to 51%. • Differential taxes, the requirement to employ a certain number of nationals or provide training for them, availability of work permit or prior residency.	27%	72%	51%	46%
Movement of natural person • Nationality, citizenship or residency. • More favourable treatment is accorded to top management or specialists, if their entry is related to the commercial presence.	3%	91%	11%	79%

Source: UNCTAD (1998g)

5.10.1.2 Travel Agencies and Tour Operator

According to the WTO (1998h), 80% of the countries that presented commitments in TTRS also presented commitments in travel agencies and tour operators. Regarding cross border supply, since the type of services offered by travel agencies and tour operators can be, and often is provided cross-border into the territory of another member state, this mode of supply is therefore relevant to the travel agencies and tour operator sub-sector. 49% of the 89 countries presenting commitments in this sub-sector allow travel agencies and tour operators to provide cross-border services.

Regarding consumption abroad, 56% of countries presented no restrictions for market access. Regarding national treatment the figure was higher, 70% countries presented no restrictions.

With respect to commercial presence, 27% of the members presented no restrictions in their schedule of specific commitments regarding market access. For national treatment 64% presented no restrictions. These countries are mostly in Europe and the Americas. The majority of the members use various restrictive measures regarding market access: licensing requirements (Africa), limitation on services offered (Americas), economic needs test and citizenship/residency requirements (Europe), foreign equity ceilings and other capital-related measures (Asia).

In relation to the presence of natural person, only one percent of the members presented no restrictions with respect to market access and 17 percent of them presented no restrictions with respect to national treatment, (see table 5.10). On contrast the percentage of the countries placed restriction are high in this mode of supply at 88% for market access and 69% for national treatment.

Table 5.10: Percentage of Commitments by Mode of Supply: Travel Agencies Services

Barriers to trade	Market access		National treatment	
	Full	Part	Full	Part
Cross-border • Commercial presence necessary	49%	10%	55%	15%
Consumption abroad	56%	20%	70%	13%
Commercial presence • Economic needs test. • Number of foreign travel agencies allowed fixed as a share of domestic agencies or below certain number. • Operations allowed in the market of inbound passengers. • Establishment in a form of joint venture, incorporating, private limited company; branches or subsidiaries not allowed. • Limits o foreign equity. • Mandate employment of local staff, including on the board of directors. • Residency requirement.	27%	67%	64%	27%
Movement of natural persons • Nationality, citizenship or residency. • More favourable treatment is accorded to top management or specialists.	1%	88%	17%	69%

Source: UNCTAD (1998g)

5.10.1.3 Tourist Guide Services

UNCTAD (1998j) states that this sub-sector appears as the most protected of TTRS services, the most protective countries being from the Caribbean, Latin America, Africa, and East Asia Pacific. Since guide services does not lend itself easily to the cross border supply and consumption abroad, most countries declared themselves to be unbound due to a lack of technical feasibility.

Commercial presence and natural persons appear to be the most restrictive modes of supply as most countries preferred to keep the guide profession to their citizen. They used the following types of measures: citizenship/residency requirements, licensing or outright prohibition, in combination with restrictive measures for personnel movement permitting entry to managers and expert inter-corporate transferees only.

The European countries appear the most restrictive one on both counts (see table 5.11).

Table 5.11: Percentage of Commitments by Mode of Supply: Tour Guides Services

Barriers of trade	Market access		National treatment	
	Full	Part	Full	Part
Cross-border • Lack of technical feasibility	56%	37%	59%	37%
Consumption abroad • None	78%	13%	85%	14%
Commercial presence • Non-automatic approval, licence, permit. • Establishment as a private limited company. • Nationality, residency. • Exams, entrée fees. • Supply of service only through travel agencies.	41%	54%	76%	15%
Movement of natural person • Nationality • Preference to top management or specialists.	0%	92%	13%	67%

Source: UNCTAD (1998g)

5.11 BENEFITS OF GATS TO TOURISM

GATS aim is to liberalise trade in all services and all modes of their supply. This approach is beneficial for the tourism sector because of the multitude of tourism services and their linkages with other sectors. A more complete perception of tourism services is therefore important for implementing the GATS and for negotiating new commitments.

GATS will contribute to the worldwide development of tourism (Handszuh, 1994). It will provide increased transparency by way of clear and detailed information on conditions of access and operation in all services markets of GATS members. The WTO (1998h) states that since the overall objectives of GATS and other accords of the WTO Agreements are to spur trade and economic growth, there will be more demand for exhibitions, incentive and business travel, meeting and conventions. More trade in both goods and services will mean more business opportunities for the travel trade.

UNCTAD (1998g) argues that the key resources of any service business are the financial, human and intellectual capital, if trade restrictions for these resources disappear tourism will grow and increasingly focus on quality. The tourism sector will benefit not only by allowing major tour operators and hotel chains to expand their reach world-wide, but also by opening up competition to small and medium size suppliers. So far, such suppliers have not been strong enough to overcome the existing trade barriers and have been overshadowed by big companies and monopolies.

Francois et al (1995) suggest that liberalisation in all service sectors (business services, communication, construction, finance, ...) will help tourism companies to do their job better: quicker and at lower cost. Moreover, Bergsten (1996a) states that other WTO agreements will also help the tourism sector to expand. GATT 1994 reduced barriers to the importation of tourism activity related merchandise, and TRIPS will sort out problems with trademarks and service marks in which tourism services abound. For example, requirements that foreign marks be used in conjunction with local marks would, as a general rule, be prohibited.

The World Tourism Organisation (WTO/OMT) (1996a) argues that GATS will give investors and companies new confidence that, once resources have been committed, key trading rules will not be shifted adversely. Such as on foreign partners, foreign service providers, cross-border delivery of services, establishing a commercial presence, and the like.

According to Morrison (1994), the most important benefit to tourism is that GATS will propel travel and tourism internationally. It will ease the flow of people, information and capital across boundaries. On the other hand, employees with special expertise will be able to move freely around the globe, sharpening their skills and adding value. In addition, UNCTAD (1998j) states that GATS reduces restrictions on foreign investment and the transfer of funds, which will bring new investors into the market and fuel new projects, and that, in turn, will help spread travel and tourism jobs and growth far and wide.

The WTO (1999i) points out that if the GATS is successful in dismantling the protectionism pressures and allowing the foreign companies to have access to the local market, the following advantages could result:

- **Investment:** This would help to ensure that suppliers of tourism services are not frustrated in their ability to take advantage of market access commitments inscribed in another party schedule. The tourist company seeking to establish itself in a foreign country will have the opportunity to invest in this country. This will have positive result on the balance of payments and economy of the host country.

- Tourism enterprises generally need to install, maintain and interconnect with terminal and communication equipment in order to supply tourism services in another country, for example, when a travel agent in one country makes arrangements for holidays in another.

- **Training and employment:** local staff will have to be trained and employed because bringing in a full expatriate staff may be prohibitively expensive. This will boost the transfer of know-how and technology and create new jobs.

- **Payments:** local telecommunications costs will have to be paid, thus boosting local communication revenues.

- **Taxes:** payments of local taxes will boost revenues for national treasuries.

- **Prices:** declining prices for consumers and increasing commissions for travel agents will result because of new competition.

- **Benefits in other services sectors:** the negotiated compensations will vary and could include, for example, increased business services opportunities for professionals of the hostess country in all other GATS countries.

To summarise, GATS will contribute to the worldwide development of tourism. It will provide increased transparency by way of clear and detailed information on conditions of access and operation in all services markets of GATS members.

It will also constrain and should over time eliminate government discrimination towards foreign service companies. A dispute settlement mechanism would provide rights of compensation or retaliation in cases of violation of the national treatment principle.

According to Francois et al (1995), the increasing participation of developing countries in world services trade is provided for the GATS through the negotiation of specific market opening commitments.

5.12 CLASSIFICATION PROBLEM OF TOURISM SECTOR AND THE NEED FOR TOURISM ANNEX

It is necessary to examine whether it would make sense to expand the current GATS definition of tourism, as reflected in GATS (sector 9: Tourism and Travel Related Services), to ensure that other tourism-related services activities are included when members make commitments in tourism. It should also be explored whether members consider only those aspects, such as hotel construction, transport or management specifically related to tourism.

The OECD (1998d) notes that it is very difficult to define or measure tourism with any precision. In an effort to improve understanding, the OECD Tourism Economic Accounts were developed, and the international forum on Tourism Statistics was established in 1993 by the OECD and Eurostat to further the exchange of views. Co-operation also takes place with the World Tourism Organisation. The objective is to develop Tourism Satellite Accounts in order to provide for comparable international accounts as well as an improved analytical framework. The satellite accounts attempt to measure tourism-related activity by determining what percentage of each industry is accounted for by tourism.

International tourism is defined by the World Tourism Organisation as occurring when a traveller crosses an international border. The GATS definition of tourism in general leaves out many services activities, such as computer reservation systems, transport, hotel construction, and car rentals, which are regarded by the World Tourism Organisation as key tourism-related industries. The world Tourism Organisation has stated that it is not satisfied with the current GATS definition, and would like to have it revised. Furthermore, the EC (1996) states that in the GATS, there is no definition of services per sector, instead services are described in the context of service suppliers and consumers.

In the Uruguay round negotiations of specificity of services in the GATS context was an argument responsible for drawing up special annexes to the GATS on financial services, telecommunications, air transport services, as well as maritime transport services. Meanwhile, there is no annex on tourism services.

Specificity of tourism services was, however, on the agenda of the Uruguay Round. It was first seen in the heterogeneity of such services. Heterogeneity was responsible, at the conceptual stage of the round, for not singling out tourism in the reference list of sectors, and for including core tourism services such as hotel and travel agency services under different classifications.

Handszuh (1994) states that when the working group on tourism services met twice in 1990 and reported its conclusions to the group of negotiations on services, it also emphasised heterogeneity and considered that an annex could outline the scope of this industry. However, the group moved on to primarily focus on problems facing the cross-border movement of consumers. This arose from considering that, in contrast with merchandise and other services exports, the main specificity of international tourism was the need for private consumers to cross-national borders in order to satisfy their demand.

Allard (1994) argues that it can be seen that this consumer-related approach originated because of international tourism, but apparently without taking into account the other specificity of tourism sector in that on the whole it provides services first of all for domestic tourism. According to WTO rough estimates the output of this part of tourism exceeds 9-10 times the output of international tourism (WTO/OMT, 1999b).

Based on the GATS classification, only four sub-sectors have been identified in GATS sector 9 (Tourism and Travel Related Services – TTRS):

- Hotel and restaurant (including catering);
- Tour operators and travel agencies;
- Tour guides;
- Other.

The World Tourism Organisation (WTO/OMT) (1998) argues that the classification of tourism services for the purpose of GATS is a compromise result and a convention responding to the practical need of moving forward the presentation of commitments. Given the complexity, overlaps and linkages between services, their ideal classification is perhaps not possible at all. Instead of "tourism services" the GATS classification introduces the term "tourism and travel related services". By such wording, the term corresponds partly to the United Nations/WTO definition of tourism which is described as comprising "the activities of persons travelling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business and other purposes" (World Tourism Organisation, 1995, p.17).

The subsections of tourism services in GATS are not entirely focused and in this form they are probably insufficient for tourism policy-makers and services suppliers. Tourism sectors interact with other sectors such as business, distribution, recreational, cultural and sporting services and particularly, transports. Only by comprehensive coverage of all commitment areas can policy-makers and operators be sure that tourism is completely included.

Smithies (1994) points out that transport services are of special interest to tourism as they are the means which make travel possible. For the tourism consumer buying a tour, it would be difficult to understand why its transport component should be looked upon as non-tourism in the package. The same goes for the tour operator.

In this context, the specificity of air transport services in the GATS, which is confirmed by an annex, lies in that their essential part being the right for scheduled and non-scheduled service to operate and/or to carry passengers (traffic rights) is temporarily excluded from the Agreement, while on the other hand the selling and marketing of air transport services and computer reservation (CRS) services are attributed to the air transport services sub-sector, not the tourism sector.

This again distorts the overall perception of the tourism sector. Travel agencies, for example, trade more in air transport services than air carrier outlets and they also operate computer reservation systems which are used not only for making flight reservations and issuing air tickets, but also for booking destination services and their packaging.

Furthermore, Costanzo (1994) adds that for some (tour operators, policy makers), it may also be difficult to accept that CRS services are not even specifically mentioned in the GATS classification (the commitments usually place them under" supporting services for air transport") while the same classification tends to be much more detailed in other sectors.

5.12.1 OBJECTIVES AND DEFINITIONS OF TOURISM ANNEX

After the conclusion of the Uruguay Round, a number of events held have provided ample arguments in favour of a more specific treatment of tourism services under the GATS. Two events in particular, a seminar in Milan organised by the World Tourism Organisation in December 1994 and the UNCTAD Expert Meeting on "Strengthening the Capacity of Developing Countries for Trade in Tourism Services" held in Geneva, have analysed the nature of tourism and the types of barriers that should be subject to further attention in the next exercise of progressive liberalisation of trade in services, as provided for in GATS Article XIX.

More recently, in the international conference, "Towards a Better Partnership in International Commercial Transactions in Tourism" (Tunis, June 1999), the WTO Secretary General expressed his dissatisfaction with the treatment received by tourism under GATS, calling for the development of an Annex on Tourism that could better handle the specificity of the sector during and after the next round of services negotiations.

One common element of these events was the insistence of participants on the need to focus on the tourism sector as a whole for the purpose of multilateral trade negotiations, to include travel reservation services, air and other transportation services and other travel-related financial services. In particular, this has been consistently supported by the World Tourism Organisation and private sector organisations, such as the WTTC (UNCTAD, 2000).

One recent development of direct relevance is the consolidated definition of the tourism sector that has resulted from the International Conference on the Measurement of the Economic Impact of Tourism in Nice (France) in June 1999, and which adopted a comprehensive methodology of the Tourism Satellite Account (TSA).

In this view, the World Tourism Organisation (2000) called for the recognition of the specificity of tourism services and for the creation of an annex on tourism services. According to the World Tourism Organisation (2000), an annex on tourism is needed because:

- In the present agreement it is not possible to deal with the specific and heterogeneous nature of tourism as a cluster, in particular in line with the more encompassing definition adopted by the United Nations and WTO;

- It is possible to monitor neither progressive liberalisation nor the compliance with commitments undertaken under "tourism and travel-related activities", in particular to meet the objectives of GATS article IV (increasing participation from developing countries);

- Specific commitments undertaken following the "request and offer" approach to develop sectoral schedules in the World Trade Organisation again would fail to eliminate the barriers to trade in tourism services, especially in the related transportation services and travel distribution systems (including tour wholesalers, tour operators, global distribution systems/ computer reservation systems and travel agents) pertaining to a large extent to consumption abroad;

- As a general shortcoming of the Uruguay Round Agreements, of which the GATS is an integral part, it is not possible to deal with the trade implications of anti-competitive conduct. UNCTAD (1998j) identifies the widespread nature of practices in tourism. Hence, the favourable balance of trade in tourism services for developing countries would be in danger, because of the failure of existing provisions in the GATS to discipline the barriers and anti-competitive practices identified, thus reducing further the share of value-added that is kept by developing countries. This would continue to attempt against the environmental and economic sustainability of tourism for development (Vellas and Becherel, 1995). Thus, in order to integrate into the GATS the necessary safeguards that would discipline anti-competitive conduct in the tourism cluster, experts agreed to recommend in the UNCTAD (1998j) meeting that the way forward was to include competitive safeguards into an Annex on Tourism.

According to the WTO (1999f), developing countries face the rather unpromising prospect of launching a round of negotiations based on the existing provisions in the GATS, which will not be enough to achieve an effective and transparent degree of trade liberalisation in tourism that results in their increasing participation in world trade in services.

Developed countries, on their part could continue to observe the increased vertical and horizontal integration of key activities in the tourism cluster, without being able to counter their international anti-competitive effects. Consumers in developed countries, moreover, could continue to see a deterioration of tourist destinations unable to preserve and develop under conditions of social, economic and environmental sustainability.

Thus, in order to follow up on the need to complement the GATS to achieve these objectives a draft Annex on Tourism has been tabled by the World Tourism Organisation, in order to elaborate up on the provisions of the Agreement with respect to measures ensuring an effective and progressive liberalisation of trade in tourism services that is consistent with the needs for sustainable development of the sector, including through co-operation efforts and the prevention of anti-competitive practices in the tourism cluster.

In this annex, the WTO (1999c) defines tourism in a wider scope than occurs in the Tourism and Travel Related Services sector. The definition includes:

1. Recognising the specificity of trade in tourism services, and in particular:
    - Its nature resulting from a cluster of diverse sectoral services offered to tourism consumers by persons engaged directly or indirectly in the supply of such services;
    - Its reliance on transport and travel distribution systems for the effective access consumers to tourism destinations and tourism services, in particular for the exercise of consumption abroad;

2. "Tourism" means the activities of persons travelling to and staying in places outside their usual environment for not more than one consecutive year for leisure, business and other purposes.

3. "Tourism cluster" includes those services which are characteristic and connected to tourism, both forming part of services conventionally denominated as specific to tourism, as well as services non-specific to tourism.

4. "Tourism characteristic services" are those services that, in most countries, would cease to exist in meaningful quantity or those supply would be significantly reduced, in the absence of tourism. They include:
    - Accommodation services:
        a. Hotel and other lodging services;
        b. Tourism housing services on own account or for free.

- Food and beverage services.

- Passenger transportation services:
  a. Intercity rail services;
  b. Road transportation services;
  c. Water transportation services;
  d. Air transportation services;
  e. Auxiliary services to transport.

- Transport equipment rental.

- Travel agency, tour operators and tourist guide services:
  a. Travel agency services;
  b. Tour operator services;
  c. Tourist information and tourist guide services.

- Cultural services.

- Recreation and other entertainment services.

5. "Tourism connected services" are those services that are supplied to the service consumer in volumes, which are significant for the consumer and/or the supplier but are not included among tourism characteristic.

6. "Sustainable development of tourism" means the process of re-investment of tourist revenues in tourist destinations for:
   a. Meeting the need for additional capacity to supply tourism services in the future;
   b. Implementing and enforcing internationally agreed quality and environmental standards;
   c. Integrating local communities to the conception, management and upgrading of all activities in the tourism cluster.

7. "Travel distribution systems" include travel agencies, tour operators, tour wholesalers, computer reservation system and global distribution systems.

In July 2000d, the WTO welcome the first comprehensive negotiating proposal relating to tourism in the Council in special session from the World Tourism Organisation and several developing countries.

5.13 GATS AND AIR TRANSPORT SERVICES

During the Uruguay Round, it was felt that air transport is characterised by specific features that would not allow the WTO Members countries to unconditionally extend the application of the GATS main provisions to these services (Smithies, 1994).

According to the EC (1998a), the international air transport sector is governed by a highly complex system of bilateral agreements (some 3000 bilateral agreements world-wide), regulated by a multilateral organisation, ICAO and IATA. In principle, these bilateral agreements that cover routes, capacity and prices govern access to the airspace itself and, therefore, access to the supply of air transport services. Reciprocal "traffic rights" are granted among countries to the exclusive benefit of their own national airlines. This bilateral tradition is also motivated by the importance of ensuring a similar national preferential treatment when allowing market access to foreign air transport services providers. Given this, most States were concerned to ensure that new arrangements would not disrupt the established global network of air services or create a dual system of regulation.

Smithies (1994) states that the airline industry was particularly concerned to avoid the creation of a dual system of regulation with some States applying GATS obligations and others applying existing arrangements. It felt that if new trade concepts were to be applied to air transport, ICAO was best qualified to take into consideration the industry's particular characteristics and regulatory arrangements and structures.

Katz (1995) points out that air transport services are covered only in small part by the GATS. At present, the Annex on Air Transport Services covers only three "doing business" issues within the scope of the accord:

- Aircraft repair and maintenance services (but not line maintenance);
- The selling and marketing of air transport services;
- Computer reservation system (CRS).

From the very first draft of the Annex in the Uruguay Round, its main feature was a broad carve-out of all traffic rights and services directly related to the exercise of air traffic rights from the scope of application of GATS disciplines. These are defined in the widest sense to include routes, traffic rights, capacity, pricing and the criteria for the designation of airlines (e.g. ownership and control requirements). They are sometimes referred to as hard rights or the basic authorisation required when operating services to and from another country as opposed to soft rights.

The solution embodied in the Annex revealed a compromise between those who wanted a very limited application of the GATS to aviation and those who wished to ensure that the coverage of the sector be meaningful enough to engage the sector in a truly multilateral liberalisation process. The Annex provides in its paragraph 5 that "The Council for Trade in Services shall review periodically, and at least every five years, developments in the air transport sector and the operation of this Annex with a view to considering the possible further application of the Agreement in this sector" (WTO, 1995a, p. 312).

The present coverage of air transport by the GATS results from paragraphs 2 and 3 of the Annex on Air Transport Services.

According to (WTO, 1995a, p. 311), Paragraph 2 states that the Agreement, including its dispute settlement procedures shall not apply to measures affecting:

(a) Traffic rights, however granted; or
(b) Services directly related to the exercise of traffic rights,
except as provided in paragraph 3 of this Annex.

Paragraph 3 states that the Agreement shall apply to measures affecting:

(a) Aircraft repair and maintenance services;
(b) The selling and marketing of air transport services; and
(c) Computer reservation system (CRS) services.

"Traffic rights" are defined in paragraph 6 (d) of the Annex. The expression "services directly related to the exercise of traffic rights" is not defined, but the fact that paragraph 3 is presented as an exception to the exclusion in paragraph 2 implies that the three covered services are regarded as "directly related". Each of these covered services is defined in paragraph 6 (a), (b) and (c) respectively.

Stephenson (1999) points out that the air transport sector is the only sector with a "positive list" of services covered by the Agreement – those services directly related to the exercise of traffic rights listed in paragraph 3 of the Annex – and it is therefore important to be sure that the definitions of these three services are operationally watertight. Moreover, the absence of a definition of services that are not "directly related to the exercise of traffic rights" and which are covered by the GATS, creates uncertainty about the coverage of the Agreement and the scope of the Annex.

It should be noted that although air transport is exempt to a large extent from GATS rules, it is nevertheless covered by some of the obligations in the GATT. Article III of the GATT provides that the national treatment obligation applies to the internal transport of goods. Article V of GATT likewise establishes detailed and strong disciplines as regards the transit of goods– though Article V.7 specifies that the Article does not apply to the operation of aircraft in transit, but rather to the air transit of goods (including baggage) (GATT, 1994).

It is also worth noting that some "air transport" services are covered by the GATS under other headings, for example, leasing of aircraft as business services and crew training as educational services.

5.13.1 ANALYSIS OF ECONOMIC, TRADE AND REGULATORY REGIMES OF AIR TRANSPORT SERVICES COVERED BY THE ANNEX

5.13.1.1 Aircraft Repair and Maintenance Services

Aircraft repair and maintenance activities are defined in paragraph 6 (a) of the Annex as meaning "such activities when undertaken on an aircraft or a part thereof while it is withdrawn from service and do not include so-called line maintenance" (WTO, 1995a, p. 311). This definition would seem to correspond broadly with what the industry calls "Maintenance, Repair and Overhaul" (MRO).

According to the ICAO (1997), the MRO market was valued at between US$ 23 and 28.5 billion in 1996. Forecasts suggest a market of US$33 billion in 2005; the figure was only US$16 billion in 1987. Nonetheless, notwithstanding this growth in absolute value and in current dollars, the relative weight of maintenance in the operational costs of airline companies is stable and may even be declining slightly (1986 - 8.2 percent; 1991 - 10.5 percent; 1992 - 9.9 percent; 1993 - 8.8 percent; 1995 - 8.5 percent). This stability can be explained partly by the increase in traffic and the faster growth of other operational costs, and partly by improved productivity, achieved both within airline companies and through outsourcing of maintenance.

According to the WTO (1998g), most of the maintenance was traditionally undertaken by public companies. The main reason for public intervention was concern for quality and flight safety. The applicable regulations take several forms:

- First there are security regulations defined multilaterally by the International Civil Aviation Organisation (ICAO);
- Secondly, national civil aviation authorities occasionally enact additional standards and ensure that service providers respect these standards, both on national territory and abroad, through certification programmes;
- Finally, in order to avoid conflicts of jurisdiction which might result from this certification of foreign suppliers, a series of bilateral agreements on air safety is being developed, alongside the start of harmonisation and mutual recognition of

certifications. An example of this is the co-operation between the US Federal Aviation Administration (FAA) and the Joint Aviation Authorities of EU Member States (WTO, 1999c).

The certification of foreign suppliers is sometimes subject to stricter rules than for nationals (for example, certification by the FAA has unlimited validity for American suppliers but must be renewed every one or two years for foreign suppliers). However, they do not have extra-territorial effect in the strict sense since their consequences operate only on the territory of the certifying State (total or partial restrictions on over-flights and servicing in the absence of certification).

Among the modes of delivery, Modes 2 (consumption abroad) and 3 (commercial presence) seem by far the most important in this sector. The presence or absence of restrictions on consumption abroad of air maintenance services is critical. Thus the liberalisation in 1988 of FAA rules, which until then permitted foreign repairs of American aircraft only in emergencies, has led to an increase of 150 percent in the number of foreign repair stations, according to US International Trade Commission (1998). In the same way Mode 3 conditions the establishment of foreign maintenance facilities in third markets.

5.13.1.2 Selling and Marketing of Air Transport Services

Paragraph 6 (b) of the Annex defines selling and marketing of air transport services as "opportunities for the air carrier concerned to sell and market freely its air transport services including all aspects of marketing such as market research, advertising and distribution. These activities do not include the pricing of air transport services nor the applicable conditions" (WTO, 1995a, p. 311).

This definition is clearly restricted to selling and marketing activities undertaken by the airline company itself, and does not cover these activities when carried out by CRS and travel agents.

IATA (1998) points out that new forms of distribution are emerging in which the airline company, instead of using a specialised intermediary such as a travel agent, uses a partner that controls a telecomms or banking infrastructure. Thus, American Airlines and Continental, in combination with American Express, have introduced "smart cards" combining membership and credit functions and permitting the electronic delivery of tickets, seat reservations, boarding cards, mail tags and so on (IATA, 1999). At present these services are available only at interactive terminals in airports, but such terminals will soon be widely distributed. ICAO (1999) argues that E-ticketing is likely to grow, in particular, on heavily used domestic routes (shuttle services) because it reduces waiting time and personnel costs. The terminals can also be managed by the airline company alone; partnership with a bank is not essential. Another example of this type of partnership is that between the Bank of Hawaii and Hawaiian Airlines for the sale of tickets through automatic telling machines (IATA, 1999).

The Annex definition says nothing about those to whom sales are made. Potentially, therefore, it covers not only direct sales to private or business clients but also block sales of seats to travel agencies and tour operators (notably in the charter market). However, according to Dogains (2001), it would seem unreasonable to go so far as to include in the definition retail sales of seats by airlines to travel agents, since here the essential business is that of the travel agent, for whom the airline company is merely a supplier. Members may wish to consider whether there are points in this area, which require clarification.

The coverage of the term "air transport services" as used in the definition may also be worth discussion. It certainly includes the sale of passenger tickets and also the sale of airfreight by means of bills of landing, since no distinction is made between passengers and freight. But whether it should be understood to cover ticket sales for such services as business aviation and carrying skiers to mountain tops is not so clear.

IATA (1999) states that from the economic point of view, the direct sale of tickets on regular flights by airline companies accounts for between 20 and 30 percent of all tickets sold, with significant differences between different companies. A first approximation to the size of the market would be the value of operational expenses for "ticketing, sales and promotion", as reported by the airline companies. Smithies

(1994) states that in 1994, this was US$ 37.5 billion and in 1995 US$ 40 billion – about twice the size of the market for maintenance and ten times that for CRS services. Depending on the year in question, ticketing, sales and promotion account for between 15.5 and 16.5 percent of operational expenses. However this figure includes commission paid to travel agents.

According to IATA (1999), the cost of issuing air tickets varies considerably according to the means of distribution used. It is US$ 8 per ticket via a standard travel agency using CRS, US$ 6 when the agency reserves the ticket directly from the airline company and US$ 1 when the individual client makes his own reservation on-line. Airline companies are seeking to reduce distribution costs and for this purpose have placed ceilings on commissions paid to travel agencies, and have introduced direct sales via informatics systems as described above. All of the companies are developing Internet reservation facilities. Such sales are growing rapidly, particularly in the U.S. market. Though the number of sales offices operated by the airlines themselves is only 20-25 percent of the number of travel agencies, their share of computer terminals is closer to fifty percent.

5.13.1.3 Computer Reservation Services

Computer Reservation Services (CRS) are defined in paragraph 6(c) of the Annex as "services provided by computerised systems that contain information about carriers' schedules, availability, fares and fare rules, for which reservations can be made or tickets may be issued" (WTO, 1995a, p. 311). The definition does not specify by or to whom the service is delivered. The classic pattern of CRS activities can be illustrated as follows:

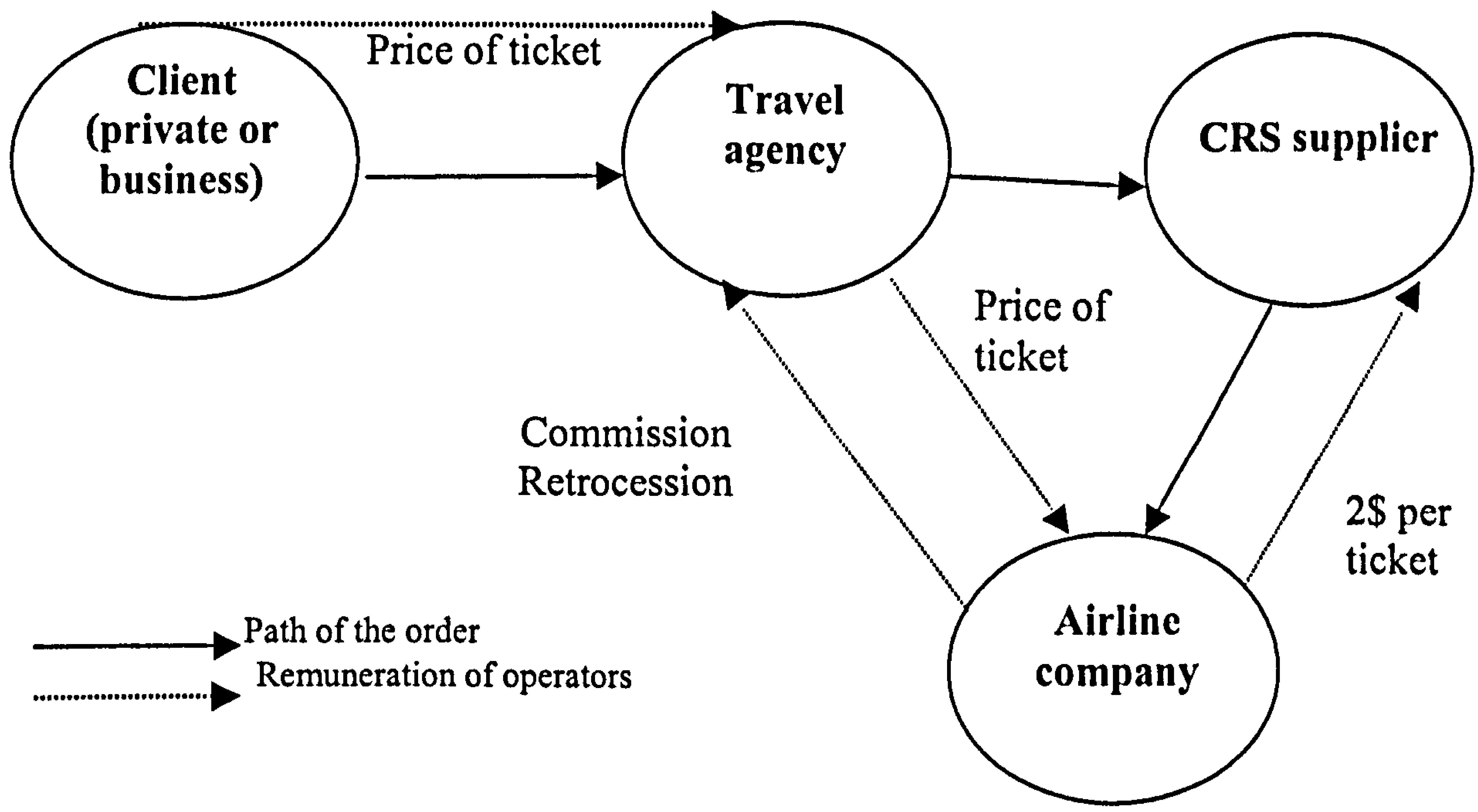


Figure 5.3: Classic Pattern of CRS Activities

Source: WTO (1998a)

In this classic pattern (which dates from 1976) the CRS is not put directly at the service of the individual client, who is obliged to go through a travel agency. Theoretically the travel agency can use several CRS suppliers. In practice, such investments would be costly (since terminals and programme use have to be rented) and futile (since all CRS suppliers have all flights in their inventory there is no point in using several), so in practice the travel agent uses a single CRS supplier who will grant him free or discounted use of the equipment after a certain volume of reservations. The CRS supplier is paid US$ 2 per ticket by the airline company (WTO, 1998b).

This classic pattern of trade was no doubt in the minds of those who negotiated the Air Transport Annex. However, the definition in paragraph 6 (c) would also appear to cover CRS services provided to the public directly, which have multiplied with the expansion of the Internet. These services offered directly to the customer are of two types:

- Those provided directly by traditional CRS suppliers such as SABRE's Travelocity (see figure 5.4 (a));

- Services provided through Electronic Reservation Services Providers (ERSP) a legal and commercial category recently identified by IATA with a view to their incorporation in its collective Billing Settlement Plan (see figure 5.4 (b)).

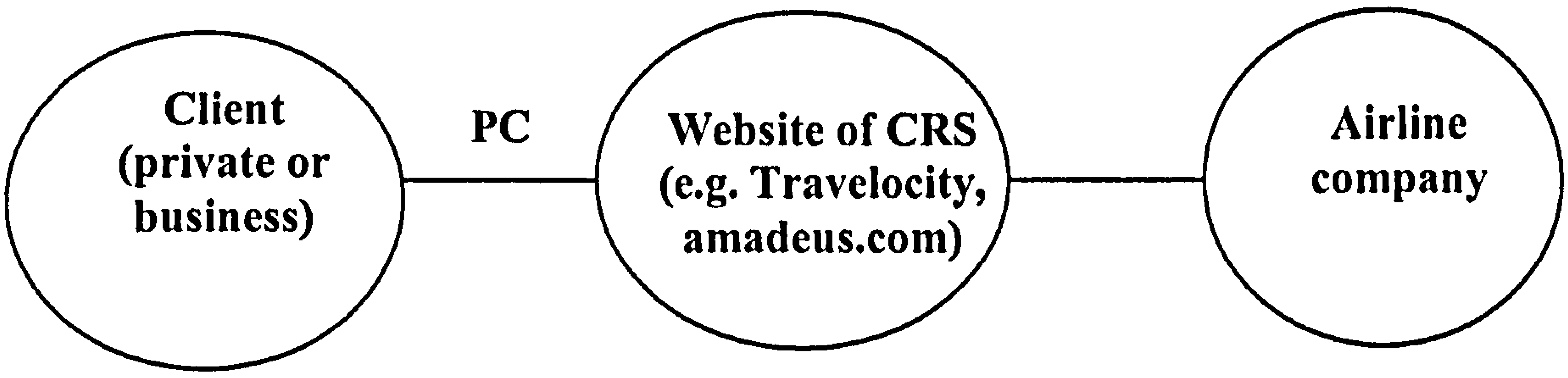


Figure 5.4 (a): Direct CRS Services

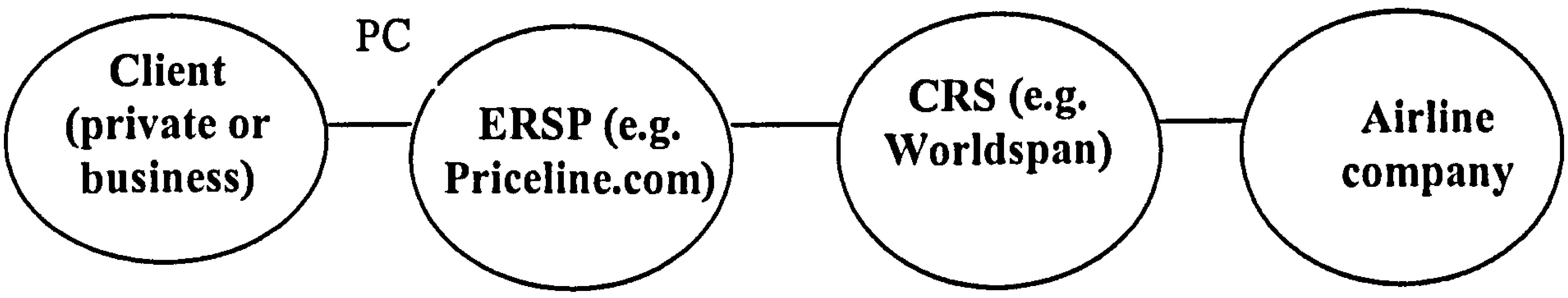


Figure 5.4 (b): Indirect CRS Services

Source: WTO (1998a)

The ERSP website does not hold complete information on flights and these providers must therefore themselves have recourse to a classic CRS provider.

Nonetheless from the client's point of view the ERSP supplies the full range of services covered by the Annex; timetables, seat availability, tariffs and tariff regulations, bookings etc. The definition does not imply that the information supplied must be exhaustive.

UNCTAD (1999f) argues that the definition of CRS would cover the following:

- Websites of airline companies which permit reservations on several companies belonging to the same alliance (see figure 5.5 (a));

- Systems by which airline companies permit direct access by travel agencies to their own seat inventory or even to that of other companies, thus bypassing the

CRS: such systems have been developed in particular by Continental airlines (see figure 5.5 (b)).

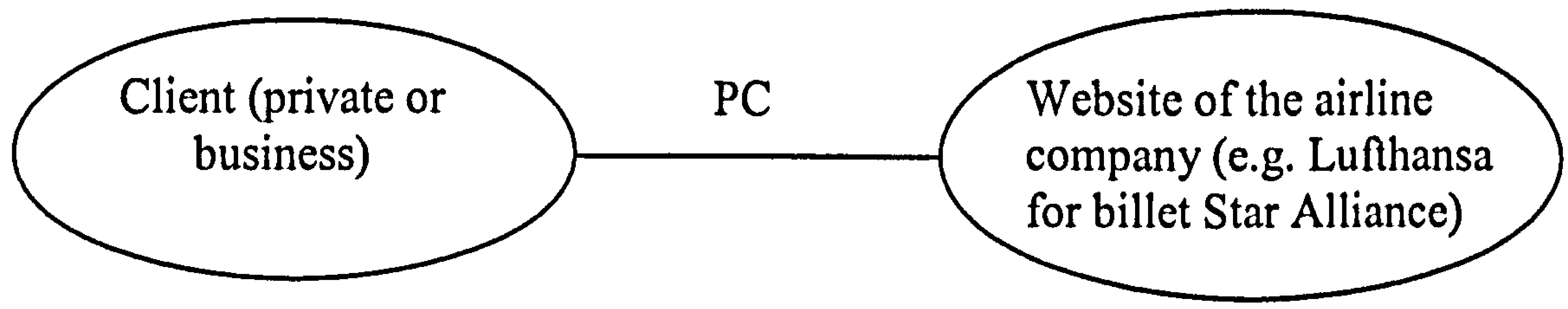


Figure 5.5 (a): CRS and Websites of Airlines

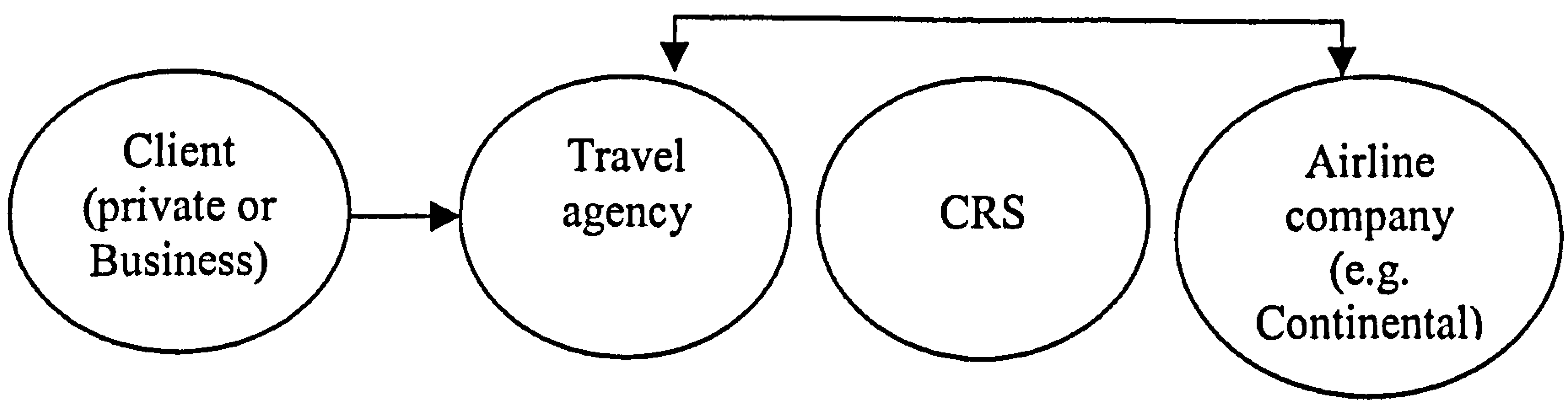


Figure 5.5 (b): CRS and Travel Agencies

Limam (1994) states that the number of possible combinations between the various operators involved has thus multiplied. Though it would appear that the Annex definition is broad enough to cover all of these, there may be some legal uncertainties arising from the facts that:

- Certain services are covered elsewhere (e.g. travel agency services);
- CRS suppliers provide many services not related to aviation (car rentals, train, ferry, hotel reservations etc.). Such services are of course covered by the GATS in any case, but would presumably not be covered by a commitment on CRS services in the air transport sector;
- The dividing line between CRS and selling and marketing is not altogether clear. In some schedules they are committed together as "selling and marketing including CRS" whereas selling and marketing which is defined as being carried

out by the airlines themselves, is in principle a narrower category than CRS which are provided to travel agencies as well as airlines.

The WTTC (1997a) argues that the development of the regulatory regime has been determined to a large extent by the property rights of the airline companies. The CRS companies were founded by airline companies which, though they were obliged to include the flights of competitors in their databases in order to offer the complete range of flights available, quite logically used their subsidiaries to promote in the first instance their own flights. To do this the "screens" showing flights between two given cities were set up so that the flights of the parent company showed up first, before those of competitors. As public authorities became aware of this problem and began to take measures to suppress it, other more subtle programmes were designed. This explains the appearance in the early 1980s of "Codes of Good Conduct" under which a CRS supplier was authorised to operate only if it undertook an obligation to give non-discriminatory treatment to all airlines.

These regulations, which imply reciprocity-based treatment, have been the subject of MFN exemptions. Nonetheless, as appears from the following table compiled by ICAO, this reciprocity regime has not prevented the establishment of the major suppliers, which tends to confirm the general view in the economic literature and in the profession to the effect that these problems of "collusion" have largely evaporated for the "classical" CRS suppliers. They recur however, on the websites operated by the airline companies (Smith, 1995).

Table 5.12: WTO Members with MFN Exemptions on CRS Services

(Members with commitments are shown in bold type)

Members	1995 Number of Vendors	1998 Number of Vendors	Evolution
State			
Austria	4	4	
Belgium	5	4	-1
Bulgaria	3	1	
Denmark	4	4	
Finland	4	4	
France	5	4	-1
Korea	2	4	+2
Kuwait	0	2	+2
Germany	5	4	-1
Greece	4	4	
Iceland	2	2	
Ireland	3	4	+1
Italy	5	4	-1
Liechtenstein	0	0	
Luxembourg	5	4	-1
Netherlands	4	4	
Norway	4	4	
Poland	5	3	-2
Portugal	4	4	
Romania	1	3	+2
Singapore	5	4	-1
Slovenia	1	1	
Spain	4	4	
Sweden	4	4	
Switzerland	4	4	
Thailand	2	4	+2
United Kingdom	6	4	-2
United States	5	4	-1

Source: WTO (1998a)

Some bilateral aviation agreements, such as that between the US and Canada of 1995, contain provisions designed to achieve the same purpose (WTO, 1999c). ICAO also produced two Codes, in 1991 and 1996, containing similar obligations as to "neutrality" and undertakings on non-discriminatory access to the market, which are in many ways comparable to those in the GATS. Thirty states adopted the 1991 Code. The 1996 Code replaces the 1991 Code in its entirety. So far, nine States, of which eight are WTO Members (Fiji, France, Kingdom of the Netherlands-Aruba, Kuwait, Portugal, Romania, Thailand and the United States), have adopted this Code.

Changes in the capital structure of CRS companies confirm this trend towards neutrality: the parent airline companies are now seeking to recover their heavy investments in informatics and to realise the potential capital appreciation – hence the trend towards public flotations (18 percent of SABRE in 1996, 35 percent of Galileo in 1997 and Amadeus in 1998 - though the latter has just announced the temporary abandonment of its flotation because of the depression of the market).

In terms of the GATS modes of supply, trade is essentially conducted under mode 3 (Commercial Presence). The typical way of organising a CRS supplier is to establish in each country a "National Marketing Company" (NMC) with which the local airline company or important local travel agencies are often associated. This local company then markets the service to local travel agencies and provides after-sales service for the programmes installed by the centralised technical service of the CRS. However, it sometimes happens that a national market is covered by a National Marketing Company in a neighbouring country. In this way, Amadeus covers 120 countries with only 55 NMCs. In these cases CRS services are supplied under modes 1 and 2. Mode 4 is also relevant to some extent in the context of the installation of the complex informatics system, which requires highly qualified personnel.

5.14 ANALYSIS OF THE COMMITMENTS

5.14.1 Aircraft Repair and Maintenance

Out of the 112 states that have signed the Final Act, 45 Members (counting individually the Member States of the EU/12) have made commitments on aircraft repair and maintenance (34 percent of all members). Two of the 45 have used their own *sui generis* definitions of the scope of this activity. Fourteen Members have refereed to the CPC and eight have made explicit reference to the definitions in the air transport Annex: the remainder have used the precise terms of paragraph 3 of the Annex without referring to it.

With respect to national treatment, commitments seem relatively liberal. In Mode 1, 15 Members have committed to this sector without limitations. Of the 19 Members, which have made no commitment under this mode, 17 considered that the cross border supply of these services was not technically feasible. Members may consider it worthwhile to discuss this point, in the hope of arriving at a common view. One possibility would be to distinguish activities which can be supplied at long distance, such as electronic transmission of data needed for maintenance, diagnosis of problems, etc., from those, such as replacement of a part or repainting, which require the physical proximity of the service supplier and the aircraft. The same question arises in relation to other modes of transport (WTO, 1998a).

Commitments under Mode 2 (consumption abroad) appear very liberal, since 42 Members have offered it with no limitations and only three have made no commitment for this mode. (One of these three Members also maintains MFN exemption under which preferential treatment is accorded to certain suppliers of maintenance services outside its territory). Under Mode 3, 34 Members have offered the sector without limitations and eight have done so with limitations (on investment screening, obligation to establish a registered office, licensing or authorisation requirements, residence requirements and foreign equity limitations). In Mode 4, 43 of the 44 schedules follow the classic formula – no commitment except as indicated in the horizontal section. The remaining Member has made no commitment, horizontal or otherwise, under this mode (Limam, 1994).

National treatment limitations either reflect those in the market access column or are more liberal, but for two exceptions (one reference to the horizontal section under Mode 3 and one case where there is no national treatment commitment although a commitment is made in market access) (see table 5.13).

Table 5.13: Insert Analysis of Commitments Made by Members on Maintenance Services (Number of Full, Partial and Non-Commitments by Mode of Supply)

	Mode 1			Mode 2			Mode 3			Mode 4		
Maintenance	**F**	**P**	**N**	**F**	**P**	**N**	**F**	**P**	**N**	**F**	**P**	**N**
Australia			x*	x			x				x	
Austria	x			x			x				x	
Bulgaria			x*	x			x				x	
Canada	x					x		X			x	
Chile			X			x	x				x	
Cuba	x			x			x				x	
Czech Rep.			x*	x				X			x	
Ecuador			X	x			x				x	
El Salvador	x			x				X			x	
EC			x*	x			x				x	
Finland			x*	x			x				x	
Gambia	x			x			x				x	
Guatemala	x			x			x					x
Guyana	x			x					x		x	
Honduras			x*	x			x				x	
Hungary	x			x			x				x	
Iceland			x*	x			x				x	
Japan			x*	x				X			x	
Kenya			x*	x					x		x	
Korea												
Morocco	x			x			x		x		x	
Nicaragua	x			x			x				x	
Norway			x*	x			x				x	
Panama	x			x			x				x	
Philippines			x*	x				X			x	
Poland	x			x			x				x	
Romania			x*	x				X			x	
Slovak Rep.			x*	x				X			x	
Slovenia			x*	x			x				x	
Suriname	x			x			x				x	
Sweden			x*	x			x				x	
Switzerland			x*			x	x				x	
Thailand	x			x					x		x	
Turkey	x			x				X		x		
USA			x*	x			x				x	
TOTAL	15	0	17*	31	0	3	23	8	4	1	32	1

Source: WTO (1998a)

5.14.2 SELLING AND MARKETING OF AIR TRANSPORT SERVICES

Thirty-four Members, counting 12 EU Member States individually, have made commitments in this sector. Two Members have defined this activity in a *sui generis* manner and one, which has not made commitments, has used a *sui generis* definition for its MFN exemption. Three Members have referred to the CPC – either to

CPC 7469 (other services related to air transport) or to CPC 74710-74720 (travel agency and tourist organisation services/tourist guide services). Three Members have included in the definition the selling and marketing of computer reservation systems. Six have made an explicit reference to the definition in the Annex. Finally, two Members have limited the scope of their commitments, one by excluding the selling and marketing of air transport services for a series of raw and processed agricultural products, the other by limiting its commitments to advertising and the creation of regional offices (EC, 1996).

According to UNCTAD (1999f), in Mode 1, 26 Members have committed this sector without limitations, one subject to an obligation to open sales offices on the territory of the country concerned. Eight have made no commitments (two on the ground of technical non-feasibility). In Mode 2, commitments are more liberal. All 33 Members who have committed this activity have done so without limitations; only three have made no commitments. In Mode 3, 28 Members have made commitments without limitations, one with limitations and seven have made no commitments. In Mode 4, 31 Members refer to their horizontal commitments, one makes a commitment without limitation and two make no commitments.

As regards national treatment, the commitments either match in essence the entries in the national treatment column or are more liberal. In 18 cases (counting EU Member States individually), limitations relate to use of computer reservation systems and to MFN exemptions intended to cover reciprocity requirements in that matter. These limitations concern Modes 1 and 3 and are all drafted in the same terms: "for distribution through CRS of air transport services provided by CRS parent carrier: unbound". In three cases, national treatment limitations differ from those in the market access column (one reference to the horizontal section, one case in which national treatment is unbound and one providing for exemption from VAT on a reciprocal basis).

MFN exemptions for this activity are of two kinds. The most common (24 cases counting EU Member States individually) covers both selling and marketing and CRS services: these are designed to obtain equivalent treatment on the basis of reciprocity. They cover all countries where there is a CRS supplier or an aviation company using CRS, are of indefinite duration and are justified by reference to the inadequacy of multilaterally agreed rules for CRS services. Twelve cases concern European Members and in these, reference is sometimes made to Community regulation. Their transatlantic counterpart is largely similar but defines selling and marketing more broadly, and establishes a link with the Chicago Convention and with bilateral agreements. The other kind of exemption (three cases) covers selling and marketing only. One is formulated in very general terms, while the others relate to provisions under bilateral agreements, which may involve reciprocal restrictions, or preferential treatment, for selling and marketing activities.

Table 5.14: Insert Analysis of Commitments Made by Members on Selling and Marketing Services (Number of Full, Partial and Non-Commitments by Mode of Supply)

	Mode 1			Mode 2			Mode 3			Mode 4		
Selling and Marketing	**F**	**P**	**N**	**F**	**P**	**N**	**F**	**P**	**N**	**F**	**P**	**N**
Austria	x			x			x				x	
Bulgaria	x			x			x				x	
Chile			x*			x	x				x	
Cuba	x			x			x				x	
Czech Rep.			x	x					x		x	
EC	x			x			x				x	
Finland	x			x			x				x	
Guatemala			x	x					x			x
Honduras			x	x					x			x
Iceland	x			x			x				x	
Japan	x			x			x				x	
Kenya	x			x			x		x		x	
Korea			x*	x			x				x	
Morocco	x			x			x				x	
New Zealand	x		x	x		x	x		x		x	
Norway	x			x			x				x	
Romania	x			x					x		x	
Slovak Rep.			x	x					x		x	
Slovenia	x			x			x				x	
Suriname	x			x			x				x	
Sweden	x			x			x				x	
Thailand			x			x		x			x	
Turkey		x		x			x			x		
TOTAL	15	1	8	21	0	3	17	1	7	1	20	2

Source: WTO (1998a)

5.14.3 COMPUTER RESERVATION SYSTEMS SERVICES (CRS)

Thirty-nine Members (counting 12 EU Members individually) undertook commitments on CRS services. This figure (29.5 percent of WTO Members) is relatively high for a transport activity. Table 5 in the Annex shows that here too commitments are relatively liberal.

One Member has defined this activity in a *sui generis* manner. The same Member, and one other, have referred to CPC 7523** ("Data and message transmission services"), another Member has referred to CPC 7469 ("Other services related to air transport"). As stated above, eight Members have included CRS under marketing services. Eight have referred explicitly to the Annex definition while the reminder have simply used the title "computer reservation system services".

As regards market access, 35 Members have made commitments without limitation under Mode 1, while one has done so with limitations (accesses authorised only through the public switched network). Three have made no cross-border commitments. In Mode 2, 38 Members have made unlimited commitments, and one has left this mode unbound. In Mode 3, 33 Members have made unlimited commitments, one has a limitation on investment screening and five make no commitments. In Mode 4, 37 Members make reference to their horizontal commitments, one has no limitation on this Mode and one leaves it unbound.

National treatment commitments essentially reflect those under market access, though some are more liberal. In seven cases, limitations relate to the use of CRS and to the MFN exemptions covering reciprocity legislation in this connection. In one other case, reference is made to the horizontal section; this does not appear in the market access column. MFN exemptions on CRS services are of three kinds:

- One of these covers all sectors including CRS and all types of air transport regimes;
- The second consists of exemptions covering both CRS and selling and marketing, (in one case CRS alone) and is intended to secure reciprocal treatment;

- Thirdly there are two exemptions designed to accord preferential treatment to a particular CRS system or to air carriers using it:
    - One of these permits only companies in partnership with a major CRS supplier to establish their own system;
    - The other permits access to national tourist agencies via the dedicated SITA network only to CRS providers designated by the carriers of the country benefiting from the exemption.

Table 5.15: Analysis of Commitments Made by Members on Computer Reservation Services (Number of Full, Partial and Non-Commitments by Mode of Supply)

	Mode 1			Mode 2			Mode 3			Mode 4		
CRS	F	P	N	F	P	N	F	P	N	F	P	N
Australia	x			x			x				x	
Austria	x			x			x				x	
Bulgaria	x			x			x				x	
Canada	x			x				x			x	
Chile	x					x	x				x	
Costa Rica			x	x					x		x	
Cuba	x			x			x				x	
Czech Rep.			x	x					x		x	
Ecuador	x			x			x				x	
EC	x			x			x				x	
Finland	x			x			x				x	
Guatemala	x			x			x				x	
Guyana	x			x			x				x	
Honduras	x			x					x			x
Hungary	x			x			x				x	
Iceland	x			x			x				x	
Japan	x			x			x				x	
Kenya	x			x					x		x	
Korea		x		x			x				x	
Morocco	x			x			x				x	
New Zealand	x			x			x				x	
Norway	x			x			x				x	
Romania	x			x			x				x	
Slovak Rep.			x	x					x		x	
Slovenia	x			x			x				x	

Source: WTO (1998a)

5.14.4 OTHER COMMITMENTS

These "other" commitments are summarised in Table 6 in the Annex. The sector in which there are most commitments (by five Members) is "Services auxiliary to air transport" which includes airport management services, air navigation control services and other related services such as cleaning, disinfection, fire services, hangars and towing. The commitments scheduled for this sector are very liberal, only one Member having scheduled limitations (on foreign equity participation and the concession regime). Closely linked with this sector is that defined by one Member in a *sui generis* manner as "use of ground maintenance equipment", for which this Member has made commitments under Modes 3 and 4.

Aircraft leasing with crew has also been the subject of commitments by 4 Members, one of whom has scheduled a limitation having to do with the required form of legal entity.

Finally, two Members have made commitments without limitations under CPC 731 "air transport passenger services".

5.14.5 OTHER MFN EXEMPTIONS

Regarding the application of the MFN principle (Most Favoured Nation), 28 countries took exemptions regarding at least one of the three types of services covered by the Agreement. Most of these exemptions related to CRS services, and the sale and marketing of air transport. Seven exemptions taken by five Members fall into two categories:

- Fiscal exemptions;
- Exemptions related to transport activities.

Four Members have between them taken five exemptions providing for reciprocal exemption from various taxes, relating to all countries and of indefinite duration. Two Members have taken reciprocity-based exemptions covering the treatment given specifically to suppliers of air transport services (see table 5.16).

Table 5.16: MFN Exemptions in Air Transport Services

Members	Maintenance	Selling/ Marketing	CRS	Others
Austria		x	x	
Bulgaria		x	x	
Canada	x	x		x
European Community		x	x	
Finland		x	x	
Iceland		x	x	
Korea			x	
Kuwait	x	x	x	
Liechtenstein		x	x	
Norway		x	x	
Poland		xx	x	x
Romania		x		
Singapore			x	
Slovenia		x	x	
Sweden		x	x	
Switzerland		x	x	
Thailand		x	x	x
Turkey				xxx
USA		x	x	x
TOTAL	2	17	16	7

Source: WTO (1998a)

5.15 POSSIBLE FURTHER WORK ON THE CLASSIFICATION OF AIR TRANSPORT SERVICES

Supply-side factors in air transport common to other service sectors, such as quality, efficiency and a favourable image, are vital for penetration of the world market for air transport services. Like other service sectors, air transport has a public service function which has to be taken into account, and public and national security considerations are important. What particularly distinguishes the air transport sector are the physical limits to liberalisation and the existing regulatory structure in which the degree of negotiated market access is the determining factor in market penetration (UNCTAD, 1999f).

According to Morrison (1994), there are several reasons why Members may undertake further work on the classification of air transport services:

- The current Annex on Air Transport in the General Agreement on Trade in Services (GATS) rules out its application to traffic rights and services related to traffic rights. The Annex does, however, list three services related to air transport to which the rules of the GATS do apply. Commitments so far in these three sectors are limited.

- In a number of other areas, the application of the GATS may be unclear. There is a need to clarify the coverage under the existing wording by considering a more detailed classification of the air transport sector, including related activities. The coverage of the Agreement can then be tested more easily. The lack of a definition in the Annex of "services directly related to the exercise of traffic rights", from which it follows the lack of a definition and a clear understanding of what is included in services not directly related to traffic rights. However, there are commitments in a number of schedules on aviation services other than repair and maintenance, CRS and selling and marketing, in the view of the Members concerned, these are presumably services not directly related to traffic rights. Comparisons are made more difficult by the lack of a concordance between the definitions in the Annex and those in Tourism and Travel Related Services.

- There are many services ancillary to all forms of transport which can be offered either in conjunction with air transport services or in multimodal combinations, and it may be desirable to reach an understanding on the treatment of such services for scheduling purposes.

- Attention should also be paid to a number of services (for example air catering services and refuelling services) which are rendered to passenger flights but whose relationship with the Annex is not clear.

- It would also be valuable to reach a clear understanding on the coverage by the GATS of aviation activities other than air transport (for example recreational flight, crop-spraying by air, flight surveys, geological or archaeological, aerial photography and publicity, etc.

- There are also important auxiliary services (essentially airport services) which provide service to other forms of aviation than air transport and which to this extent cannot be regarded as directly related to the exercise of traffic rights.

It is also not clear that all services covered by CPC ("Supporting services for air transport") are directly related to the exercise of traffic rights and therefore excluded from the GATS. These include airport operation services, excluding cargo handling, air traffic control services and "other supporting services for air transport" such as cleaning and disinfection of aircraft, fire services and so on. All of these are needed and provided in connection with all forms of aviation, not merely the transport of passengers and freight. Furthermore, the link between some of these services, like disinfection, and the exercise of traffic rights seems somewhat remote, even if the disinfection is practiced in a passenger aircraft.

Furthermore, the definition of traffic rights in paragraph 6 (d) of the Annex includes the right to operate services for hire (rental and leasing of aircraft), but it is not clear from the text or from the negotiating history whether this includes both charter services (including the block-booking of seats by travel agents) and leasing of aircraft. The economic importance of this sector is considerable: in 1996, 34 major leasing companies owned 1760 jets worth US$ 41 billion, that is 13.5 percent of the world fleet. Aircraft leased by airlines from other airlines and manufacturers accounted for another 4.6 percent of the world fleet (ICAO, 2000).

On the other hand, IATA (1998) argues that franchising is of growing importance in air transport because it complements the development of regional companies and of "hub" strategies. It also reduces the risks of operating in areas where direct operations might not necessarily be profitable. A typical example is the franchised partners of British Airways: British Mediterranean Airways in the Middle East and Central Asia and GB Airways in the Iberian Peninsula, Malta and the Middle East. There are many other examples. The definition of franchising services in CPC includes franchising activities in the air transport sector. Nevertheless, although franchising is not mentioned in the definition of traffic rights, it could well be thought to be an activity directly related to the exercise of traffic rights because the essential purpose of franchising activities is to channel regional traffic towards international and intercontinental flights.

Catering services are economically important, because hundreds of thousands of meals are served every day on board aircraft. The size of the market is estimated at between $10 and $13 billion annually (ICAO, 2000). Airline companies have often created specialised subsidiaries in this field (Servair for Air France, Sky Chefs for Lufthansa, SAIR Relations for Swissair) which may sometime also work for other airlines. The definition of restaurant services in CPC 64201 includes services provided on the move (ships and trains are explicitly mentioned, and the clear intention is to include aircraft also). Whether these services are directly related to the exercise of traffic rights is not clear; the Annex definition provides no guidance.

Fuelling services, which are a typical airport service, also give rise to classification questions. They are necessary for all types of aviation activity, not just the transport of passengers and freight, and it would seem odd in principle (and inoperable in practice) to maintain that they are covered by the GATS when the fuel is supplied to a crop-spraying aircraft but not when it is supplied to an airliner. The retail sale of fuel is not mentioned in the Annex, but is nevertheless the subject of a number of commitments. CPC classifications in this area are particularly confusing, and offer no real guidance.

5.16 STRUCTURAL PROBLEMS OF THE GATS

According to Low and Mattoo (1999), progressive liberalisation is a central objective of the GATS. How well will the structure put in place perform in expanding the coverage of bindings and inducing substantial liberalisation of access to service markets? Concerns can be expressed regarding both dimensions. Many practitioners and observers have pointed to aspects of design of schedules and schedule techniques that introduce an unwelcome element of opacity and interpretative ambiguity into the GATS, making the agreement less effective as a system of rules and vehicle for further liberalisation. The Problems include the lack of transparency, sector-specificity, the modalities of scheduling, the overlap between national treatment and market access obligation, and the relationship between market access and MFN. All of these reflect the structural weaknesses of the GATS.

5.16.1 TRANSPARENCY

The GATS does not do enough to further the goal of transparency, which should be a fundamental objective of any multilateral agreement. Hoekman (1999) states that it is widely recognised that the "scheduling technology" used in the GATS does not greatly promote transparency. No information is generated on sectors, sub-sectors and activities in which no commitments are scheduled, most often the sensitive ones where restrictions and discriminatory practices abound. A commitment consisting of the single word "unbound" does not impart any information, except that the government does not want to have its hands tied in any way, and that the regulatory stance is therefore likely to be restrictive. This lack of transparency is a serious shortcoming when one considers the nature and origin of impediments to trade in services (i.e. regulatory barriers at both the national and sub-national levels).

In addition, there is nothing in the GATS or the WTO that encourages and assists countries in generating comprehensive information on applied policies and evaluating the impact of these policies. Some progress was made in the Uruguay Round with the creation of the Trade Policy Review Mechanism. Hoekman (1999) argues that more should be done, priority should be given to greatly improving statistics and data on trade barriers.

Much discussion has taken place of about the difference between a positive and negative list approach to ensure transparency. A positive list approach is one where parties to an agreement specify which sectors are covered. A negative list approach, by contrast, requires that agreement specify which sectors that are not covered by commitments. Low and Mattoo (1999) state that the GATS uses a positive list approach to identify sectoral coverage and then a negative list approach to indicate limitations to market access and national treatment commitments in respect of sectors listed in schedules. Sauve (1995) has argued strongly in favour of a negative list approach, which has also advocated by Snape and Bosworth (1996).

Finger and Schuknecht (1999) argue that a negative list approach will foster greater transparency, as it will be immediately obvious which sectors or activities are excluded from coverage. Currently there is simply no comprehensive cross-country source of information for service providers concerning the regulatory regime that applies. If members remain firmly committed to the positive list approach, agreement should be sought that all members compile and publish (through the WTO Secretariat) this information, on a sector-by-sector basis, within an agreed upon time frame. Without such transparency, negotiations are made more difficult, and will be driven primarily by powerful export interests.

There is also a great deal of variance across countries regarding the "transparency" of the commitments themselves. Some members have clearly made substantial efforts in listing all relevant applicable laws and regulations that may limit access. Others simply make reference to a limitation, but do not specify the applicable laws. Limitations that are mentioned in a schedule may be rather vague, and therefore open to interpretation. Dispute settlement in the GATS is therefore likely to revolve around interpretation of country schedules. Ambiguity, in conjunction with the importance of the schedules, suggests that the number of cases may be substantial.

5.16.2 SECTOR-SPECIFICITY

The structure of the GATS implies that negotiations in the services area are (and will be) sectoral, and can be expected to be driven very much by the concerns and interests of the major players in each industry. At some level, a sectoral approach is probably unavoidable, given the widely differing regulatory regimes across countries and sectors. But to foster MFN-based liberalisation, sectoral agreements should be firmly embodied in a framework of general rules and disciplines. The emphasis put on "absolute" sectoral reciprocity may prove to be especially troublesome insofar as incremental liberalisation becomes less feasible and the scope for cross-issue trade-offs is reduced. The scope for turf fights between regulatory agencies may be enhanced, making it more difficult to take an economy-wide perspective and make trade-offs across issues.

The positive list approach may also make it more difficult for a government to add sectors to its schedules. Those industries affected can argue against their inclusion: "why us not them?" (referring to other sectors that are excluded). Under a negative list approach each industry seeking "special treatment" is put in the position of having no justify why the rules should not apply to it, even though they apply to every one else; in a positive list, the government must be ready to confront each industry that it seeks to subject to multilateral disciplines. As mentioned previously, it is likely that the easy sectors will have been included first, leaving the more sensitive sectors to be dealt with in the future.

5.16.3 DEFINING SPECIFIC COMMITMENTS IN TERMS OF MODES OF SUPPLY

Whichard (1999) points out that the GATS defines trade in services in terms of the four modes of supply: cross-border supply (mode 1), consumption abroad (mode 2), commercial presence (mode 3), and the movement of natural person (mode 4). These modes are also used for scheduling purposes. Two issues that have arisen in regard to the use of modes for scheduling purpose are first; there is the question of overlap between modes, specifically modes 1 and 2. Second, the definition of likeness of foreign and national services and services suppliers across modes of delivery raises a number of interpretative difficulties with regard to the rights acquired through specific commitments at the modal level.

Moreover, Mattoo (1997) states that the problem of modal overlap attracted particular attention in the context of the negotiations on trade in financial services. In essence, the question is whether a cross-border financial service transaction should be classified as a mode 1 or a mode 2 transaction, which is virtually impossible to determine under existing definitions. If the transaction is deemed to have originated with a supplier in one jurisdiction selling a service to a consumer in another, then from the point of view of the jurisdiction in which the consumer is located, this would be classified as cross-border delivery, or a mode 1 transaction. If, on the other hand, the consumer initiates the transaction or solicits the service, it could be classified as consumption abroad. This potential confusion between mode 1 and mode 2 transactions obviously becomes important if the commitments scheduled by a member are not identical in both modes.

The second problem referred to above concerns the possibility that a commitment on a particular service in one mode can be undermined by the absence of commitments in another mode, or by an interpretation of the relationship among modes that treats a given service as an "unlike" product by virtue of the fact that it is delivered via one mode rather than another (Hoekman, (1999). If, for example, a member has accorded unrestricted access to the foreign supply of a service under mode 1 in respect of both market access and national treatment, and then offers a subsidy to national producers of the same product in the domestic market – a measure seemingly consistent with the GATS in the absence of a national treatment obligation under mode 3 – then clearly the subsidy will alter the conditions of competition and undermine the value of the model commitment. Similarly, even if the subsidy was granted to both foreign and national producers operating in the national economy, or in other words, even if the members concerned had a national treatment commitment under mode 3 as well as mode 1, the grant of a subsidy to domestically-based producers would undermine the value of the mode 1 commitments. Conversely, a tax on mode 3 production would undermine the rights of suppliers under this mode in relation to suppliers under mode 1.

In addition, there is nothing in the national treatment provisions of the GATS which suggests that the mode of supply is a determining factor in defining the "likeness" of a service – alternative modes of delivery may be used to supply "like" services. If this interrelation were adopted, then something would need to be done about the effects of an intervention under one mode on the value of a commitment under another. At present, probably the only recource would be a non-violation complaint under the WTO's dispute settlement understanding. On the other hand, the manner in which trade in services is defined through the modes, and the schedules are designed, suggests that commitments are indeed mode-specific (Sauve, 1995).

5.16.4 THE RELATIONSHIP BETWEEN MARKET ACCESS AND NATIONAL TREATMENT

Mattoo (1997) states that GATS schedules of specific commitments consist of market access undertakings potentially subject to six limitations (Article XVI) and national treatment undertakings which may be conditioned by a kind of specified discriminatory measures (Article XVII). The national treatment principle is defined in the Agreement as a specific principle applies only to the sectors specified in the schedule of the specific commitments. Although the non-generality of national treatment was probably unavoidable, the impact of the GATS would have been substantially greater if it had been required that the status quo be bound for all sectors.

The market access article is a step in the right direction, but it should also have been a general obligation subject to a negative list of exemptions. Moreover, it is too weak. Market access is not defined in the GATS, there being instead a finite list of six measures prohibited in principle, leaving others that have similar effects uncounted. These six categories define what, in effect, are meant by market access for services and are made up of both non-discriminatory and discriminatory quantitative restrictions.

According to Hoekmann and Messerlin (1999), the bifurcation between market access limitations and discriminatory measures potentially raises some confusion about the true nature of members' scheduled commitments. The problem is confounded by a scheduling convention set out in the Article XX: 2 of the Agreement, which states:

"Measures inconsistent with both Articles XVI (market access) and XVI (national treatment) shall be described in the column relating to Article XVI. In this case the inscription will be considered to provide a condition or qualification to Article XVII as well" (Mattoo, 1997, p. 113).

This provision is intended to deal with situations where discriminatory market access limitations are scheduled, or in other words where restrictive measures fall within the scope of both market access and national treatment. In such cases, the "Article XX: 2" of the Agreement states that the relevant measures should be inscribed in the market access column of the schedule and would be understood to provide a condition or qualification to national treatment as well. Thus, the market access column contains measures that are inconsistent with market access only (non-discriminatory market access limitations) and with both market access and national treatment, but there is frequently no indication as to whether the measures concerned are non-discriminatory or discriminatory.

Sauve (1995) suggests that two related problems arise from an ambiguity in the definition of domains, and a lack of clarity in the scheduling technique. First, since the precise overlap between market access and national treatment is not identified, the scope of the national treatment obligation remains unclear. The schedules, therefore, provide no clue as to which, if any, quantitative restrictions are inconsistent with Article XVII (national treatment).

Secondly, the scheduling methodology leaves the status of commitments ambiguous on measures which fall in the domain of both market access and national treatment when a member's commitments with respect to the two are not the same. Suppose a member has undertaken only a commitment to provide national treatment, and not full market access. In this case, there is no way of knowing (in the absence of a proper definition of national treatment in relation to market access) whether any unscheduled improvements in market access would have to respect full national treatment. The problem of identifying the scope of national treatment is most acute in mode 3 (commercial presence). Securing market access under this mode is in practice a two-stage process- one set of measures will define the terms of entry for a foreign investor and another will establish the conditions for post-entry activity.

Furthermore, Low and Mattoo (1999) point out that at least three possibilities suggest themselves in relation to the scope of national treatment in these circumstances. First, national treatment may be deemed to apply to all present and future market access commitments with respect both to entry and post-entry operations (full national treatment). This interpretation is in line with the text of national treatment which states that this provision applies to all measures affecting the supply of services. Second, national treatment may apply only to market access commitments entered into at the time the national treatment may only apply with respect to initial markets access commitments and only to the post-entry operations of these entities.

However, Marcus (2000) argues that the differences among these three options are stark in terms of the value of national treatment commitments, and the fact is that there are many entries in members' schedules where it would be impossible to determine which of these definitions of national treatment apply. What would be the value, for example, of a schedule entry in mode 3 recording no commitments under market access ("unbound"), or specifying the requirement of an economic needs test, and a full commitment under national treatment (none, meaning no limitation)? One interpretation is that national treatment is to apply, which would only provide a guarantee of non-discrimination in relation to measures covered by national treatment other than those covered by market access.

5.16.5 THE RELATIONSHIP BETWEEN MARKET ACCESS AND MFN

According to Snape and Bosworth (1996), to the extent that market access restrictions are maintained, concern can also be expressed regarding their possible impact on the MFN obligation. Given that the in principle prohibited market access restrictions are quantitative in nature (limits on the number of firms, their assets or their turnover) there appears to be a natural incentive to negotiate increases in market access in quantitative terms as well. Suppose that currently only three foreign firms are established, and are restricted to four lines of activity. Trade negotiators might then seek to increase the number of firms and/or lines of permitted activity. That is, the GATS approach to liberalisation has a built-in incentive for the reciprocal negotiation of VIE. If a country permits a few additional firms into a sector, the nationality of these firms may matter, in that incentives may exist to ensure that firms from certain countries obtain access. Market access/share criteria may result in managed trade, as voluntary import/investment expansion agreements can easily be inconsistent with MFN.

5.16.6 THE RELATIONSHIP BETWEEN SCHEDULED COMMITMENTS AND DOMESTIC REGULATION

The structure of the GATS requires that a tenable distinction be made between measures intended as limitations on access to the domestic market by foreign-produced service and service suppliers, and measures adopted in pursuit of public policy objectives. This is the distinction between measures falling under Article XVI (market access) and XVII (national treatment) on the one hand, and Article VI (domestic regulation) on the other. The approach has been to maintain that if a regulatory intervention embodies a market access restriction, the measure should be inscribed under Article XVI (market access). If there is a discriminatory element, then the measure should be scheduled under Article XVII (national treatment). In all other cases, the disciplines of domestic regulation Article apply.

This raises the question of how clear in practice the distinction will be between market access Article and domestic regulation Article. Whether a public policy measure falls under one or other of these provisions may not always be clear at the margin and will require legal interpretation. Similarly, a discriminatory measure that is "excessive" in the sense of going beyond what is necessary to achieve a public policy objective would not be dealt with as an unnecessary barrier to trade under domestic regulation Article, but as a measure in need of liberalisation under national treatment Article.

5.17 GATS AND THE DEVELOPING COUNTRIES

5.17.1 SPECIFIC PROVISIONS RELATING TO DEVELOPING COUNTRIES

Participation of the developing countries in the trade in service liberalisation process was one of the key objectives of the Uruguay Round. Developing countries were concerned about the existing imbalance between the development of services in their economies compared with those in the developed countries. They feared that liberalisation of trade in services would result in massive foreign investment from developed countries before they had a chance to develop their domestic services. On the other hand, the developed countries considered that some developing countries had certain services sectors that were already liberalised and competitive, and that at least for these sectors there should be commitments for full liberalisation (Hoekman, 1999).

The WTO (1996a) argues that the GATS offers a number of general opportunities to increase services-related production and trade for all contracting parties. It also contains a number of concepts, principles and rules dealing specifically with developing countries. The provisions of the GATS that refer to developing counties are an integral part of the agreement.

It should be noted at the outset that the GATS contains no provisions similar to Part IV of the GATT on more favourable treatment of developing countries (special and differential treatment), or to the (unilateral) arrangements for tariff preferences that exist for merchandise trade flows (e.g., the Generalised system of preferences). Instead, all provisions relating to economic development are considered integral elements of the agreement. The preamble of the GATS states that the general goal of participants is "to establish a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalisation, and as a means of promoting the economic growth of all trading partners and the development of developing countries" (UNCTAD, 1996b, p. 56). Moreover, the agreement expresses the desire to facilitate the increasing participation of developing countries in trade in services and the expansion of their services exports including, inter alia, through the strengthening of their domestic services capacity and its efficiency and competitiveness. "The preamble explicitly recognises the right of all parties to regulate the supply of services within their territories, and the particular need of developing countries to exercise this right to meet national policy objectives" (UNCTAD, 1994, p. 144). Finally, the preamble states that "particular account of the serious of the difficulty of the least developed countries is to be taken" (WTO, 1995a, p. 327).

According to the GATT (1994), Articles mentioning the level of economic development of parties pertaining to developing countries include Article III (transparency), IV (increasing participation of developing countries), V (economic integration), XII (measures to safeguard the balance of payments), XV (subsidies), XIX (negotiation of commitments) and XXV (technical co-operation). Moreover, the telecommunications annex contains a separate Article on technical co-operation in the telecommunication industry. World Bank (1995b) argues that Article IV and XXV are the only two provisions that deal exclusively with developing countries.

(a) Article III (Transparency)

The Article requires all parties to establish enquiry points within two years of the entry into force of the agreement. Such enquiry points are to provide, upon request, specific information on any of the laws, regulations etc, that pertain to the operation of the agreement. Individual developing countries may ask for appropriate flexibility regarding this time limit due to the practical difficulties that they may face in quickly establishing a full inventory of all aspects of the regulatory regimes that affect trade in services (WTO, 1996a).

(b) Article IV (Increasing participation of developing countries)

UNCTAD (1997a) points out that in Article IV entitled "Increasing participation of developing countries", the first provision that deals directly with the situation of developing countries, has three paragraphs.

- The first states that the developed countries have to assist the increasing participation of developing members by making market access commitments in sectors and modes of supply, in which the developing countries have an export interest. Moreover, increasing participation of developing countries shall be facilitated through negotiated specific commitments relating to access to technology on a commercial basis; the improvement of access to distribution channels and information networks; and the liberalisation of market access in industries of export interest to them.

- The second part of the Article IV states that developed countries are required to set up contact points within two years of the entry into force of the agreement to facilitate the access of developing country services suppliers to information relating to the commercial and technical aspects of specific services; requirements for registration, recognition and obtaining of professional qualifications; and the availability of services technology.

- The final provision of Article IV states that special priority be given to least developed countries in the implementation of the first two paragraphs.

(c) Article V (Economic Integration)

Article V on economic integration allows parties to the GATS to enter into preferential trade-liberalising agreements. Such agreements are subject to certain conditions, the major ones being that they have substantial industry coverage, provide for national treatment for the industries involved and do not result in higher external barriers for services and services suppliers originating in non-member states. However, paragraph 3 of Article V states that where developing countries are parties to such agreement, "flexibility shall be provided for regarding the conditions in accordance with the level of development of the countries concerned, both overall and in individual sectors and sub-sectors" (UNCTAD, 1994, p. 145). Moreover, in the case of agreements involving only developing countries, more favourable treatment may be granted to juridical persons owned or controlled by natural persons of the parties to such an agreement (WTO, 1996a).

(d) Article XV (Subsidies)

The GATS disciplines for subsidies remain to be drafted. Article XV simply recognises that subsidies may have distortive effects on trade in services and states that all parties shall enter into negotiations with a view to developing the appropriate multilateral disciplines to avoid such trade-distortive effects. However, such negotiations must recognise the role of subsidies in development programmes of developing countries, for flexibility in this area (EIU, 1996).

(e) Article XIX (Progressive Liberalisation)

The GATS is based on the notion of progressive liberalisation to allow national policy objectives to be respected and levels of development, both overall and in individual sectors. Article XIX (progressive liberalisation) states that, to achieve the objectives of the agreement, the process of progressive liberalisation through the future negotiation of commitments shall allow for appropriate flexibility for individual developing countries for opening fewer sectors, liberalising fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign services suppliers, attaching to it conditions aimed at achieving the objectives of increasing the participation of developing countries in world trade. These are in fact guidelines for the conduct of future rounds of negotiations on trade-liberalisation rather than obligations to be undertaken. Again, least developed countries are to be treated more preferentially, in accordance with article IV (WTO, 1996a).

(f) Article XXV (Technical Co-operation)

Article XXV on technical co-operation is the second provision that deals with developing countries. It consists of four lines. The first two state that services suppliers needing assistance shall have access to the contact points required by Article IV (increasing participation of developing countries). The second two state that technical assistance to developing countries shall be provided at the multilateral level by the competent secretariat and shall be decided upon by the Council for trade in Services (i.e., all signatories acting jointly). Such assistance need not be provided solely by the Secretariat of the GATS, but can involve any multilateral organisation deemed to be competent. Examples include United Nations bodies and agencies, the World Bank and sectoral agencies such as the International Telecommunications Union, the International Civil Aviation Organisation, the International Maritime Organisation etc. These organisations already run technical co-operation programmes (World Bank, 1995a).

5.17.2 GATS IMPLICATIONS FOR DEVELOPING COUNTRIES

Snape and Bosworth (1996) argue that the GATS imposes few limitations on national policy, only requiring that no discrimination across alternative sources of supply occurs. It allows parties to implement policies that are detrimental to – or inconsistent with – economic efficiency. A good example is the Article specifying the conditions under which measures to safeguard the balance-of-payments may be taken, such measures rarely being efficient. The GATS also does not require a participating country to alter regulatory structures, or to pursue an active antitrust or competition policy.

Liberalisation of trade and investment may need to be augmented by regulatory change (frequently deregulation) and an effective competition policy in order to increase the efficiency of service sectors such as finance, transportation, and telecommunications. If liberalisation is simply equated with increased market access for certain foreign suppliers, this may have little effect on markets that are characterised by a lack of competition. The main result will then simply be to redistribute rents across firms.

Much more importantly, many developing countries have been able to accede to the GATS with only minimal commitments. The adoption of a positive list approach was partly due to arguments by developing countries that a negative list was too resources intensive to be feasible within the time frame envisaged (completion of Uruguay Round). Acceptance of this argument, in conjunction with the willingness to accept very little in the way of scheduled specific commitments and the fact that a number of the framework's rules apply only if specific commitments are made, implies that the GATS has very few implications for the majority of developing countries. Indeed, its impact may be negative. The non-generality of national treatment and the sector specificity of market access commitments reduce the value of the GATS to governments seeking to liberalise. Lobbies that oppose liberalisation cannot be told that GATS membership implies national treatment for all sectors. Instead, it must explicitly list each end every sector to ensure that national treatment and market access obligations will apply. This clearly makes matters much more difficult for governments that need an external justification for resisting protectionist pressures (Hoekman and Braga, 1997).

5.17.3 GENERAL OPPORTUNITIES OFFERED BY THE GATS

According to WTO (1996a), the main benefit embodied in the GATS is an increase in the economic efficiency of the service sectors of the signatories brought about by an improvement in domestic resource allocation and greater access to lower-cost/higher-quality service inputs. In addition, a higher level of domestic efficiency will bring with it increased export opportunities. In practice, export and import opportunities are strongly interdependent; higher quality and or/ cheaper services inputs are frequently necessary for more efficient and competitive domestic production and thus greater exports of services and goods. Opportunities for both imports and exports will be a function of the general obligations contained in the GATS and the specific commitments undertaken by parties to the agreement to provide market access and national treatment to foreign suppliers. Such opportunities are contingent upon the implementation of appropriate domestic policies, and apply to both cross-border trade and foreign direct investment FDI, as GATS pertains, in principle, to all modes of supply.

(a) Access to Imported Inputs, Know-how and Networks

Hoekman (1999) argues that before a country can start to export new products, it will have to be able to meet the quality and reliability standards that are demanded in world markets. There is substantial evidence that many of the constraints that reduce the economic efficiency of service industries of developing countries are home grown, in that governments have not always pursued appropriate policies. Thus, policy measures should focus on augmenting domestic productive capacity, increasing quality or establishing a reputation for reliable supply among others. This is crucial need from a development perspective, as it is a necessary condition for exports to increase. In the longer-run, greater exports are in turn a necessary condition for greater imports. The availability of higher-quality and –or lower- cost producer services will increase the output of goods and make them more competitive in world markets.

Sauve (1994) states that although many policies can and should be changed and implemented unilaterally, external barriers may reduce the payoff from doing so. For example, the efficient provision of travel services might require agents to have access to the major computer-reservation-systems that cover various parts of the world. If so, an agent needs to be able to import such services at the lowest possible cost. As international telecommunications are subject to two sets of regulators (at home and abroad), foreign regulations and procedures (relating to interconnection, pricing, etc.) may reduce the effective availability of access to such services. Ideally, external barriers to trade should be reduced in a reciprocal fashion, and this is of course the main incentive for engaging in reciprocal liberalisation discussions.

In the GATS, any increase in the availability of foreign services inputs will largely be a function of each country's offer, that is, the extent to which the schedules commit a country to provide market access and national treatment to foreign services and services suppliers. In general, it can be argued that the more industries offered the better, as effective liberalisation requires that foreign suppliers are given access to domestic markets and are treated equally to domestic firms. In particular, given the importance of services supplied by government procurement of service (currently excluded from GATS), countries should consider liberalising such a service as well as the private or market services covered by the GATS. Although reciprocal liberalisation is preferred, a country should not feel constrained to limit its offer (i.e., restrict the extent of its liberalisation) simply because other countries do so (UNCTAD, 1997b).

Hoekman and Braga (1997) argue that the only potential argument in favour of limiting the extent of liberalisation offers (making liberalisation conditional on reciprocal actions by other countries) is that the pursuit of such a strategy may help induce trading partners to liberalise in turn, or liberalise more. This is not a complete argument. Even if the strategy turns out to be successful, it is likely to take a long time (witness the length of the Uruguay Round), thereby foregoing the benefits of liberalisation during this period. In practice, such a strategy is unlikely to have much effect. It should be recognised that most countries are too small to be able influence the behaviour of the large traders. Non- liberalisation by trading partners simply reduces the potential gains from liberalisation, but by no means eliminates them. This is especially true in the services context, as most services production- be it by domestic or foreign firms-occurs locally, employing domestic factors of production. Most of the potential gains form liberalisation will be the result of freeing access to domestic markets. Greater access to foreign markets will frequently constitute the "icing" on the cake", not the cake itself.

(b) Export Opportunities

The GATS provides developing countries with greater export opportunities, that may arise as a result of the general MFN-treatment obligation and through the national-treatment/market access commitments listed in the national schedules. As far as developing countries are concerned, the specific commitments made by developed countries are of primary interest, since these are the major potential markets for their services, representing some 85 percent of the global services market. This is not to say that commitments by the larger developing countries are irrelevant; developing-country markets are often the major sources of demand for service exports of other developing countries (UNCTAD, 1994).

In contrast to the situation of developing countries, offers of the developed countries are clearly more comprehensive. Many industrialised countries made initial offers with 100 percent industry coverage. Furthermore, all OECD members presented an initial offer. The United States and the European Community covered about one-half and two-third of the GATS illustrative list of industries, respectively. The average unweighted coverage ratio of initial offers of industrialised countries exceeded 75 percent.

Given the wide coverage of the offers, there is less interest in calculating weighted coverage ratios than in the offers of developing countries, especially as most countries exclude the same industries; primarily air transport, services supplied in the exercise of governmental functions (e.g., central bank activities). Other industries will be exempted from the MFN-treatment obligation or excluded from national treatment schedules. It is too soon to comment on the extent to which such possibilities affect the coverage of offers, since this is still under negotiation. The main issue for developing countries is therefore what conditions affect the export of services in which they expect to have comparative advantage.

The conviction of some observers and policy-makers that developing countries have no comparative advantage in various service industries is untenable. Even though services-trade statistics are deficient, existing balance-of-payments data show that many developing countries have a revealed comparative advantage in several services. Unfortunately, the amount of research on this issue remains limited. Abstracting from tourism, there is a general belief that developing countries have a comparative advantage in labour intensive products, and that market access for labour intensive services therefore should be of greatest interest. These include professional services such as legal, accounting, engineering, consulting, medical and quasi-medical services as well as certain types of data-processing activities, software development or cleaning services.

It is for this reason that a number of developing countries sought to obtain agreement that the GATS facilitate not only trade in services, but also the movement of services suppliers, both those that require relatively little in the way of human capital as well as those requiring highly-skilled labour inputs. In this they were successful to the extent that it was agreed that the GATS encompasses the supply of services by natural persons of one party in the territory of any other party (Article I). There is no mention of skill based criteria in Article I, in the annex dealing with the movement of natural persons. Of course, this is only relevant if countries schedule services requiring the movement of such natural persons and liberalised market access and national treatment with respect to the movement of personnel. Most industrialised countries' initial offers are quite comprehensive insofar as industry coverage is concerned, but they have shied away from lifting the often stringent limitations on market access and national treatment that they apply to the temporary movement of personnel so that the depth of their offer for developing countries is typically far less generous than it may seem. Still, the fact that countries are to apply remaining restrictions on national treatment/market access on an MFN-treatment basis should improve market access conditions, given that services suppliers from developing countries may face discriminatory treatment at present.

Indeed, the potential benefits of MFN-treatment in terms of increasing market access should not be overlooked. For example, it seems likely that certain existing bilateral or minilateral trade, investment and related arrangements may be multilateralised. Possible examples are the two OECD Codes on Liberalisation of Current Invisible Operations and Liberalisation of Capital Movements, respectively, the UNCTAD Convention on a Code of Conduct for Liner Conferences and existing bilateral commercial treaties that affect trade in services, including bilateral investment treaties and bilateral friendship and commerce treaties.

5.18 BARRIERS TO LIBERALISING TRADE IN SERVICES IN DEVELOPING COUNTRIES

In order to take advantage of trading opportunities, services firms from developing countries would need to continuously keep up to date with technical and professional advances, as well as to meet and exceed international service quality standards and incorporate information technology in the provision of their services. The expansion of service exports from developing countries is dependent not only on national capabilities, but also on the quality of the telecommunications infrastructure in place and on emerging market opportunities. The effective supply of services requires the use of all modes of supply, and to effectively compete in world markets would require the liberalisation of all factors of production. The modal approach in GATS has created a flexible framework for liberalisation, as well as for the possibility of trade-offs between different modes of supply (Sauve, 1995).

Developing countries generally consider that there are imbalances between the four modes of supply of GATS (World Bank, 1999b). There has been an emphasis on mode 3 (commercial presence) in negotiations and commitments made both during the Uruguay Round and in subsequent negotiations on trade in services, but there has been considerably less progress in negotiations on commitments on mode 4 (movement of natural person). The basis for seeking equilibrium is given by articles IV and XIX of GATS, which should, in their view, be fully implemented. Developed countries, on the other hand, argue that the question of the relation between different modes of supply need to be analysed on a sector-specific basis, since the relative importance of each mode varies considerably among sectors. There is broad agreement that the mix of different modes of supply of services is also affected by technological change. In particular, advances in information technology and the rapid expansion of electronic commerce have greatly expanded the opportunities for international trade in services through mode 1 (cross border).

However, service suppliers from developing countries are faced with a number of barriers to market access, such as:

- Requirements which limited or prohibited the temporary movement of natural persons;
- A lack of credibility in foreign markets (an issue which related to quality);
- The lack of appropriate and timely market information;
- The lack of access to distribution networks, financial constraints;
- A high degree of market concentration as a result of mergers and acquisitions and strategic alliances.

Economic needs tests are a major barrier to trade in services and left considerable uncertainty as to the level of a country's commitment to market access. The adoption of specific criteria for the application and eventual removal of such tests, particularly with respect to clearly identifiable categories of professions, would be central to future efforts to liberalise trade in services. Facilitating the movement of service providers, through the introduction of streamlined GATS visas for example would enhance the service exports of developing countries.

Sauve (1995) points out that particular attention need to be given to the cross-border mode of supply of services, in view of the opportunities offered by electronic commerce for the supply of long-distance, labour-intensive services. The Internet is changing market structures and eliminating the need for intermediaries. Efforts need to be made to ensure that the access of developing countries to cross-border data flows is not constrained. International mechanisms are required to regulate and harmonise cross-border legal questions and provide competitive safeguards against the creation of monopolies. The cost of infrastructure for electronic commerce is an important barrier to export expansion. For developing countries to benefit from the opportunities offered by electronic commerce, it is important that the provisions in articles IV and XIX.2, as well as the Annex on Telecommunications, of GATS are faithfully implemented.

Developing counties would have to ensure that their service suppliers make use of new business strategies, such as joining strategic alliances, to avoid being marginalised. However, since strategic alliances might also develop into de facto industry standard-setters or price-setters, a development which might lead to the erection of new entry and access barriers, there is a need to pay particular attention to the development of national and international competition policies.

UNCTAD (1999b) concluded the main barriers, which hinder the expansion of service exports by developing countries' suppliers to be:

- Their inadequate knowledge of the international services market.

- The absence of international standards for professional services, including problems with the recognition of diplomas or qualifications, which could hinder or prevent the access of foreign professionals to national markets.

- Problems with information technology and telecommunications infrastructure: taking advantage of the potential offered by new technologies presupposed ease of access to information technology and telecommunications infrastructure, in both economic and technical-terms. The cost needed to be low and the infrastructure and access to it needed to be technically efficient. When those requirements are not met, many developing countries are unable to take advantage of the potential that information technology offered for the expansion of service exports. That is particularly the case when telecommunication services are provided in a non-competitive environment (e.g. in cases where there is a monopoly or dominant supplier), which tend to lead to high prices and offer no incentive for the technological upgrading of the infrastructure. An anti-competitive environment could arise even after the liberalisation of the telecommunications sector. Therefore, it is of the most importance that liberalisation should be accompanied by competition policies that avoided anti competitive practices in the sector.

- Weak supply capacities: most developing countries face difficulties in exporting services, and are not always able to meet quality standards in many non-traditional sectors, mainly due to their weak supply capacity.

- Concentrated market structure: in several service sectors there was a trend towards mergers and alliances between large companies, which result in a small number of large suppliers having dominant positions in those sectors. Such a situation tend to reduce competition in those sectors, change the pattern of international price-setting, alter the international division of labour within the relevant sectors, segment national and regional markets and ultimately affect developing countries; capacity to formulate national policies. The trend is particularly evident in the sectors of air transport, global distribution systems, telecommunications and software, auditing and constancy services. The consolidation of this type of market structure make it more difficult for service suppliers (particularly small and medium-sized enterprises) from developing countries to enter the international market and take advantage of the opportunities it offer.

- The lack of services development policies and export strategies: most developing countries still need to identify those service sectors in which they have or might develop a comparative advantage, in order to design and implement policies to develop the sector and its exports.

5.18.1 WHAT SHOULD DEVELOPING COUNTRIES DO TO OVERCOME TRADE BARRIERS

Developing country's service-based firms, mostly SMEs, face competition from large service-based multinationals with enormous financial strength, access to the latest technology, worldwide networks, and sophisticated information technology infrastructure. The view is widely held that, in order to overcome some of the barriers to exports of services, developing countries require technical assistance from international organisations such as UNCTAD, in terms of:

- Human resource development;
- Institutional capacity-building;
- Access to technology;
- Formulation of adequate legislation and design;
- Implementation of services development policies and strategies aimed at fostering an internationally competitive supply capacity.

Many developing countries, particularly less advanced developing countries and countries with vulnerable economies, also need to receive technical co-operation to assist them in preparing for future negotiations on trade in services in the regional and multilateral contexts (World Bank, 1998c).

The ability of developing countries to integrate successfully into the global trading system will depend, as regards services, both upon:

- Their ability to strengthen their capacity to produce internationally competitive services;
- The extent of liberalisation in the services sectors of export interest to them (UNCTAD, 1998a).

Regional trade agreements related to services are likely to influence future multilateral efforts to improve market access in services. Stephenson (1999) argues that the effective inclusion of services within sub-regional agreements among developing countries will be the key to their success. Such agreements among developing countries are also supporting growth in services exports through liberalisation of market access and national treatment within the region and by creating economies of scale and scope, building competitiveness, upgrading skills and encouraging alliances among developing country service firms.

Developing countries should therefore make a common effort to set up a policy, which could help reinstate fair rules in the distribution market and preserve the interests of weaker partners. A series of measures and policies can be adopted by the governments of developing countries and private-sector agents acting in collaboration, with the aim of diversifying the supply of tourism services, encouraging power, improving their quality/cost ratio by investing in human resource development, upgrading suppliers' negotiating skills. Again, the pursuit of initiatives at the regional and sub-regional levels can be effective in improving the bargaining power of service suppliers from developing countries. Investment in hotel infrastructure can take several institutional and contractual forms, involving both domestic and foreign capital. On the domestic front, finance may be sought from sources that are increasingly active in the tourism sector, such as institutional investors.

To conclude, in order to take further advantage of trade liberalisation opportunities and to thrive in an increasingly competitive global services environment, developing country service firms will need opportunities to continuously up-skill and keep current with technical and professional advances, as well as to meet and exceed international service quality standards and incorporate information technology into the provision of their services. Expansion of services exports from developing countries depends not only on national capabilities but also on the quality of the telecommunications infrastructure in place and on emerging market opportunities. Success requires a world class telecommunication infrastructure, and the ability to move natural persons temporarily, including on business travel, to foreign markets unimpeded by visa restrictions, a sophisticated array of financing support, and access to appropriately skilled staff.

5.19 TOURISM LIBERALISATION AND DEVELOPING COUNTRIES

Tourism services are supplied by hotels, tour operators, travel agents and transport companies. In their business relations with tour operators, many suppliers of tourism services in developing countries (hotels, tourist guides, land-transport providers) are hampered by their weak bargaining position and their lack of negotiating skills, which often result in unfavourable contractual conditions. Moreover, when these supplier firms are small and medium-size enterprises (SMEs), they face fierce competition from large companies, including those with foreign capital participation, which had resulted in sharp decreases in prices and lower quality services, which negatively affect local service providers in developing countries.

The WTO (1998g) suggests that the long distances separating many developing countries from the main tourist-generating centres and the high airfares caused by low air traffic density hamper exports of tourism services of developing countries. Although, air services are crucial to tourism-driven development, not airline ownership, many bilateral agreements encourage inefficiency in air transport by restricting market access, controlling prices and capacity, and protecting money-losing state carriers. The trend towards the liberalisation of air transport regulation, notably through the proliferation of open skies agreements, raises the question of the liberalisation of air transport within a multilateral framework. The WTO states that it will shortly be reviewing the GATS Air Transport Annex and the possibility of incorporating air transport rights into GATS disciplines.

Developing countries should therefore adopt a combination of policies to increase the efficiency of airlines and lower the prices of domestic and international flights, and ensure that their national air transport policy is consistent with their tourism objective.

Global distribution systems (GDSs) have become the main distribution and marketing tool in the international tourism trade. They are of key importance to suppliers of tourism services worldwide. The costs associated with their operation, the control of the major system by a small number of large companies and the problems of access for small service suppliers mean that suppliers from developing countries may not enjoy the full benefits of GDSs, and may represent market access barriers to smaller suppliers in developing countries. One of the weaknesses in the operation of GDSs is the absence of multilaterally agreed set of rules and its corresponding dispute settlement system, to protect the weaker player.

The impacts of tourism liberalisation under the GATS on the developing countries will depend on how much the developing countries will open their markets and how rapidly they will strengthen their industries and make them competitive internationally.

5.19.1 PROBLEMS FACING TOURISM INDUSTRY IN DEVELOPING COUNTRIES

International trade in tourism services largely takes place among developed countries. Moreover, international tourism is mainly intra-regional, as travel outside the region of originating countries of tourists represented only 22% of the total in 1999 (WTO, 2000b). Geographical proximity to the most important originating markets is clearly a major factor in successful exports, mainly due to the smaller share of the cost of air transport in overall tourism-related expenditure. Nevertheless, the decreasing cost of air travel on both regular and charter flights, especially to and from long-haul markets, has facilitated the development of tourist packages to some new destinations in developing countries. Some of the new destinations, in particular in Asia and the Pacific and in Africa, are attracting higher-income tourists and selling higher value-added services and products. The dynamic and highly differentiated expansion of tourism in developing countries over the last 10 years is reflected in changes in the ranking of developing countries in terms of tourism receipts and arrivals (UNCTAD, 1999b).

The capacity of international trade on tourism in developing countries is largely determined by the following factors:

1. Tourism Suppliers:
    - Tour operators and travel agents;
    - Hotels;
    - Air transport services;
    - CRS and GDS.

2. Infrastructure.

3. Human Resources.

5.19.1.1 Tourism Suppliers

Certain segments of the industry supplying tourism services are dominated by a few large international firms offering integrated services, particularly tour operators and hotel chains. However, other segments, such as restaurants, travel agents and independent hotels, are highly fragmented and characterised by a large number of SMEs.

(A) Tour Operators and Travel Agents

According to the World Tourism Organisation (WTO/OMT) (1997a), tourism service suppliers (e.g. hotels, inbound operators, land transport companies) in developing countries participate in the international tourism market mainly through the transactions of tour operators and travel agents from developed countries. Tour operators are the "wholesalers" of a tourism product: they manufacture package tours by bundling different tourism sub-products (e.g. transport, accommodation) under a fixed and all-inclusive price. The tour operator industry of each major market is dominated by a small number of large national firms, which compete fiercely with each other. The participation rate in package tours remains high for long-distance travel because:

- A package tour to a distant destination often costs less than a scheduled flight;
- A large number of consumers prefer to go on a group tour organised by a credible tour operator, to be assured of the quality of services when travelling to a new destination in a developing country.

Tourism suppliers in developing countries view package tours as an attractive option because:

- Package tours assure a certain flow of tourists;
- International marketing, a costly element in the tourism business, is managed by tour operators;

- A volume flow of package travellers is likely to raise investment by foreign construction companies; major tour operators and airline companies who wish to make the tourism product more attractive for consumers.

Travel agents, on the other hand, are the retailers of tourism products or sub-products, such as package tours. The travel agent industry in the developing countries is fragmented, as are the majority of firms SMEs. The main revenue of an average travel agent comes from commissions on ticket sales; travel agents are the largest distributors of airline tickets. Travel agents have a significant impact, through over-the-counter consultations and advice, on the customers' choice of destination, type of accommodation and so on.

UNCTAD (1999d) argues that the benefits and costs of package tours to service suppliers in developing countries depend to a large extent on the nature of the contracts between them and the tour operators. The contracts involve a block reservation for a future period at a negotiated price and specify the terms governing risk-sharing in the event that not all the packages are sold. The tour operator normally has the greater bargaining power during the contract negotiations; if it considers that the negotiating partner's offer is not attractive enough, it can choose another hotel in the same area, or even another region of the same country.

Tour operators thus often exercise a monopolistic power over the local tourism suppliers, such as local hotels, since, for the latter, serving package tours is a vital means of securing their occupancy rate. The asymmetry of bargaining power is clearly revealed in the contents of the contract. Often contracts last for one year or more and the risk inherent in a long-term contract to a tour operator (e.g. uncertainty of future demand for the package tour) is reduced by negotiating various conditions favourable to the tour operator. As a result, contracts frequently contain the following provisions: a substantial discount on the room price; no deposit required for the booking; payment may be made long after the departure of the clients; and the tour operator retains the right to return unfilled rooms (release back) shortly before the arrival date, without any need to pay compensation.

(B) Hotels

The global hotel market encompasses a wide range of accommodation, including full-service hotels, bed and breakfast inns, suites, self-catering short-term apartments and time sharing properties. The number of small independent and family run hotels is falling, while the accommodation offered by hotel chains is growing rapidly. The latter can be either hotel consortia (grouping independent hotels) or integrated chains. Between 1980 and 1995, the world capacity for accommodation rose from 16 million to 24 million hotel beds. The fastest increase in accommodation capacity took place in East Asia and the Pacific, particularly in Thailand, Malaysia, Singapore and Hong Kong. Of the world's total capacity in 1995, 45.1 percent was located in Europe (mainly in southern and Western Europe). The second-largest concentration of hotel accommodation is in the Americas and in the Caribbean, which accounted for 34.7 percent of world supply, concentrated mainly in North America. Hotel supply in Africa is concentrated in North Africa. The hotel supply in South Asia is expanding only half as fast as that in rest of the world, and represents less than 1 percent of total world capacity (EC, 1999a).

Hotels in developing countries, which have not associated themselves with foreign firms face competition from trans-national hotel chains integrated through GDSs and using marketing techniques such as promotional customers, service quality concepts, loyalty programmes, alliances with airlines and car rentals. In some countries, particularly islands, they are also competing with the cruise business, which have very little valued-added impact in the receiving countries. At the same time, a large number of small and medium-size hotels in developing countries face difficulties in improving quality standards and introducing the technological innovations required by international and domestic demand, mainly due to the lack of capital (WTO, 1998g).

(C) Air Transport Services

Air access in international tourism depends on the availability and conditions of air transport connecting tourist generating countries and destination countries (i.e. prices, frequencies, travel time, etc.). Air transport is a major factor underpinning international tourism in the vast majority of developing countries, but its importance for tourism varies considerably from one region to another. It is the means of transport used by the majority of tourists arriving in developing countries. Air transport developed as a result of the increase in demand for tourism-related travel, becoming, in turn, the driving force behind the development of the tourism industry. In 1999, passengers were responsible for 76 percent of air traffic volume, and for 79 percent of the total operating revenues of airlines. It is estimated that up to 40 percent of air passenger travel is for business purposes and that business travellers account for US$ 1.24 trillion in gross output world-wide in 1999 and generated 25 million jobs. Like tourism, the world air transport industry has expanded at double the pace of world output growth, and is expected to continue to do so in the coming 20 years (ICAO, 1999).

ICAO (2000) states that the main recent developments affecting air transport and the industry structure are the increased international ownership of airlines and their growing concentration, world-wide moves to liberalise and deregulate the sector, the privatisation of airlines and the formation of strategic alliances among firms. The main benefits of the latter are the cost reductions and efficiency gains that can be achieved by rationalising the joint use of resources (such as check-in facilities and ground personnel), creating synergies and providing network value (i.e. the wider coverage of points serviced by the carrier and its partners) without the need to physically expand operations. The large global alliances aim at world coverage by pooling the networks of their members. The main drawback of doing this is that the alliances can restrict competition and thus negate some of these benefits, particularly if they collectively achieve a dominant position on given routes.

(D) CRS and GDS

Reservation systems (CRSs) have been developed by large air carriers since the 1970s to process flight reservations. They later evolved and expanded to offer further services related to air transport, such as the storage of information on world-wide basis, the issuance of tickets, marketing (by displaying information on fares, discounts and conditions attached to them) or the sale of products and services. Moreover, they cover not only services provided by airlines, but also land services supplied to tourists, such as package tours, hotels and vehicle rentals. With this enlarged range of services, they became known as global distribution system (GDSs). Through strategic alliances and other forms of co-operation of mergers in the most important markets, these systems minimise their costs and reduce the need for a direct commercial presence. GDSs have significantly improved the efficiency of travel agents' business operations and their use is growing rapidly. They have become the main marketing and trading tool of international tourism, as well as a major source of income for the carriers which own them.

5.19.1.2 Infrastructure

The availability of an infrastructure for tourism is an essential element of successful tourism development strategies in the developing countries. The UNCTAD (1998h) argues that successful experiences in expanding tourism in developing countries have highlighted the fundamental importance of heavy investment in the tourism infrastructure. However, it is frequently an impediment to tourism expansion in countries where that infrastructure is deficient. This is particularly true in the case of the transport, hotel and telecommunications infrastructure. The main reason for deficiencies in infrastructure is the scarcity of public funds to finance projects. The large capital requirements for major projects to develop tourism raise the issue of the availability of public and private funds for investments and the availability of financing in developing countries.

In private investment projects, there is a trend towards less total ownership by foreign capital in developing countries, because of the costs and associated high risk (due, inter alia, to the long time before there is a retune on the investment). The alternative for foreign investors have been establishment of joint ventures with local partners and franchises of hotel chains. As far as local investors are concerned, institutional investors such as pension funds have become increasingly involved in financing hotel projects.

5.19.1.3 Human Resources

The human-resource skills of tourism service suppliers play a key role in determining the quality of the services offered. Quality in tourism services is increasingly being demanded by consumers and therefore it is gradually becoming a fundamental competitive tool for firms. It requires, inter alia, managerial, technical and language skills. Therefore, developing countries must mobilise and develop their human resources in order to expand their exports of tourism services. This includes the establishment of technical, middle and higher-level schools of hotels, tourism operations and tourism management.

However, in most developing countries the facilities to train the workforce for the tourism sector are inadequate, seriously restricting the labour pool from which supplying firms can draw, a situation which is aggravated by the fact that in most cases it is unusual for those firms to offer on-the-job training (particularly in the case of SMEs). This hampers their efforts to upgrade their services and attain international quality standards.

The WTO (1999d) points out that in order to develop the human resources for the tourism sectors, developing countries should receive technical assistance from the relevant international organisation. Moreover, international financial institutions should provide financing for human resources development and capacity-building programme.

5.20 POLICY OPTIONS FOR DEVELOPING COUNTRIES

One of the main ways to face the tough competition brought about by GATS in the developing countries is through regional co-operation mechanisms. UNCTAD (1998g) states that regional co-operation among the developing countries must be seen as one of the important adopted policy. This would help to increase the intra-regional tourism flow, pursue joint development plans and enhance their negotiation power. Regional trading agreements can provide a framework for regional co-operation.

On the other hand, WTO (1998g) argues that countries must design policy package to make themselves more attractive to tourists and to improve the bargaining positions of their tourism services suppliers, taking into account that negotiating capacity of tourism service suppliers is largely determined by the following factors:

1. Attractiveness of the country. The more attractive the country, the stronger its negotiating capacity. The attractiveness of the country depends on the following factors:
   - Relative prices: these, in turn, are strongly influenced by macroeconomics policy and fiscal policy. Macroeconomics policy (exchange rates and fiscal policies) can have a very strong impact on tourist flows. Overvalued exchange rates impair countries' competitiveness and reduce international tourist flows. This has been a particularly acute problem for many Latin American countries recently. Fiscal policy in many developing countries places a heavy tax burden on tourism service suppliers (particularly small and medium-sized enterprises). While most governments provide for tax and duty drawback paid by exporters of goods, this is usually not applied to exports of tourism services.

   - Quality of tourism services: this is increasingly demanded by international customers, so service suppliers in developing countries should pay attention to this factor. Enhancing the quality of the tourism product is also a way to improve its quality/price ratio. Suppliers of tourism services have to ensure the quality of all elements of the tourism product (including transportation, accommodation, personal services, etc.). Ideally, policies to enhance the quality of tourism services should be undertaken through co-operation between the public and private sectors. Improving the quality of tourism services was identified as a source of further growth in the sector in developing countries, enhancing their chances of achieving economic and environmental sustainability.

   - Economic proximity vis-à-vis the main generating markets: this factor includes the availability of transport (particularly air transport) to and from the country and the conditions attached to the supply of such services. In this respect, developing-country governments should carefully analyse the relationship between tourism policies and transport policies, so as to ensure that they are complementary and mutually supportive.

- Image of the country: a country's image is negatively affected by natural and man-made disasters. Travel warnings issued unilaterally by the governments of the main generating markets, while aiming at the security of their nationals, tend to overemphasise the risks of destination countries and often remain in place after the causes that justified the warnings have been removed. Another related problem for some developing countries is the unilateral certification of airports in tourist-receiving countries, which may jeopardise air traffic to these countries (and, consequently, its tourist flows) and eventually affect the viability of these countries' airlines.

- Resources and infrastructure: these define the capacity of countries to absorb increasing flows of visitors using various means of transportation. Inadequate provision of these resources generates a poor first impression of tourist-receiving countries and often leads to the emergence of a few transport carriers in dominant positions in air and maritime services.

2. Degree of dependence on the main tourist-generating markets. The promotion of both domestic and regional tourism can result in a strengthened bargaining position for tourism services suppliers from developing countries. Regional economic and trade integration schemes provide the framework for enhancing regional tourist flows. Experience has shown that international tourism accompanies international tourist flows.

3. Availability of information. The position of suppliers would be greatly strengthened if they shared information on contractual conditions, given that there is often a situation in which a few organised buyers confront a large number of uncoordinated suppliers. Suppliers' associations could play a useful role in spreading this type of information. In other words, tourism service suppliers in developing countries should co-operate in order to compete. Moreover, tourism

services suppliers also need access to information on the international market and the latest developments in it.

4. Domestic regulation. This is necessary to prevent unfavourable clauses from being included in contracts (franchising contracts with import requirements, exclusive dealing, reservations without deposit, inadequate repayment periods and other examples were cited by various speakers).

5. Operating and negotiating capacity of local suppliers. The negotiating power of local suppliers can be enhanced by policies to develop human resources, including those aimed at training in the use of new technologies.

5.21 SUMMARY

Partly as a result of an ever-widening involvement in world trade and partly in response to a decline in the growth of world trade in goods, an interest has arisen in services liberalisation that poses considerable challenges that are quite different from those in the goods area. This interest has been particularly keen since the start of the 1990s. The chapter discussed that the intangibility of services means that barriers to their trade are not normally evident at the borders. The barriers to trade in services are often more subtle and manifest themselves in the form of legislation and administrative practices. This make them less transparent than tariffs and quotas and more difficult to evaluate in terms of their restrictive impact. Moreover, there is not always a clear line between a 'measure affecting trade in services' and a 'barrier affecting trade in services'. What one government may feel is a necessary regulatory measure, applied in a non-discriminatory manner, may in fact constitute a *de facto* trade barrier in the eyes of a foreign services supplier. It is clear, however, that all-regulatory measures that are applied to foreign service providers in a discriminatory manner constitute barriers to trade.

One of the major outcomes of the Uruguay Round has been the creation of the General Agreement on Trade in Services (GATS). In some respects GATS is a landmark achievement, in other respects it can be considered a significant failure. It is a landmark in terms of creating multilateral disciplines in virgin territory whilst, at the same time, being a failure in terms of generating liberalisation.

The effectiveness of GATS can, to some extent, be measured by the schedule of specific commitments signed by each member. A country cannot become a member of GATS without having accepted at least some specific commitments that, once undertaken, are conditioned by the basic principles to assure affective market access.

It cannot be denied that the set of rules inherent in GATS attempts to produce a more level competitive field on which markets can operate. It attempts to secure transparency and standardisation that is vital to the growth of international trade in services but falls short of its intended target both in terms of scope (the exclusion of much of the airline industry) and depth.

The lack of comprehensiveness of GATS, together with the ability of Members to select those categories to which it wishes to be bound and the modes of supply that are relevant to it, ensures that there are still many 'bunkers' left in the international trading field. GATS has extended well beyond the penetration of GATT in terms of its scope and there are some Members who have suggested that it is going beyond its remit and authority by including aspects such as labour policies in its agreements.

GATS could benefit tourism and travel in several ways. It will contribute to the worldwide development of tourism. It will provide increased transparency by way of clear and detailed information on conditions of access and operation in all services markets of GATS members. As discussed in this chapter, since the overall objectives of GATS and other accords of the WTO Agreements are to spur trade and economic growth, there will be more demand for exhibitions, incentive and business travel, meeting and conventions. More trade in both goods and services will mean more business opportunities for the travel trade.

The chapter argued that the key resources of any service business are the financial, human and intellectual capital; with disappearing of trade restrictions for these resources tourism will grow and increasingly focus on quality. The tourism sector will benefit not only by allowing major tour operators and hotel chains to expand their reach worldwide, but also by opening up competition to small and medium size suppliers. The achievement of the latter is more an act of faith and the belief in a market with perfections that are not so apparent in the real world. So far, such suppliers have not been strong enough to overcome the existing trade barriers and they have been overshadowed by large companies and monopolies. There is little evidence to suggest that the adherence to GATS will enable SMEs to compete head to head with the international companies. Given the structure of the tourism industry and its dependence upon SMEs, even more apparent in developing countries, GATS is unlikely to assist developing countries in their progress.

CHAPTER SIX

METHODOLOGY

6.1 INTRODUCTION

It is not a simple task to approach a new field of research. As previously mentioned, GATS is the first multilateral trade agreement in services. Little research has been undertaken in the area of service liberalisation in general and tourism liberalisation in particular. Furthermore, multilateral agreements research is complicated due to the fact that they encompass a wide and diverse range of rules and disciplines. Most of the research into multilateral agreements has discussed the economic impacts of such agreements in the area of international trade in goods, which is often difficult to apply to service industries. Trade in services has unique features, which distinguish it from trade in goods. Regarding trade in tourism, the matter is more complicated given the features that characterise the tourism industry.

This research investigates the relationship between GATS and tourism development. It aims to measure the impacts of liberalisation and open markets for international competition in Egypt. Furthermore, since tourism is an interdependent industry, the issue of stakeholders is a fundamental one for any tourism topic under investigation.

The research is further complicated by the fact that it tries to measure the impacts of tourism liberalisation on the development of the industry. That is, the research explores and attempts to establish criteria for tourism development in a more globalised and liberalised market, taking into account global changes, such as technology, interdependency and those related to economic changes.

This chapter discusses the methodological issues applied to satisfying the objectives of the study. It discusses the steps involved in the research process and discusses the issues of reliability and validity, and the limitations faced in this research.

6.2 WHAT IS RESEARCH?

Before engaging in the research process, it is useful at this point to identify what is meant by research. Authors on research methods spend little time conceptualising the idea of research, they do not necessarily agree on what it comprises and what it aims to achieve. An examination of business and management texts tends to emphasise the logic and objectivity of research. Zikmund (1991) defines business research as "the systematic and objective process of gathering, recording and analysing data for aid in making business decisions" (Zikmud, 1991, p. 6). He suggests that the researcher must be objective, for example, the role of the researcher is one of detachment from the research process.

Sekaran (1992, p. 4) defines research as "a systematic and organised effort to investigate a specific problem that needs a solution". This is elaborated upon by saying that the processes of research inquiry have to be carried out diligently, critically, objectively and logically with the desired end to discover new facts that will help to deal with the problem situation. What is common to these themes is the claim to be 'objective' in the research process.

In many of the definitions of research, there is also an implicit assumption that research will discover something new or make an original contribution to the development of knowledge. Preece (1994) offers a much broader conceptualisation of research. He maintains that research is conducted within a system of knowledge and that research should be probing or testing that system with the aim of increasing knowledge. Finn et al (2000) add to this debate by saying that the increase in knowledge may be something entirely new and original or, more commonly, it may consists of checking, testing, expanding and refining ideas which are themselves still provisional. In particular, research should continually question the nature of knowledge itself, what it is and how it is known.

Elias (1995) also used the term 'discovery' to define research. The term can be seen as, first, the process of finding out, but to more than just the accumulation of information. Second, it provides explanation, explains why things are as they are.

The third function of research is evaluating, that is judging the success or value of policies or programmes. Corresponding to these three functions, three types of research can be identified:

- Descriptive research - finding out, describing what it is;
- Explanatory research - explaining how or why things as they are (and using this to predict);
- Evaluating research - evaluation of policies and programmes.

In some cases, particular research projects concentrate on only one of these, but often two or more of the approaches are included in the same project. The current research encompasses all three types of research.

6.3 QUANTITATIVE OR QUALITATIVE RESEARCH?

At one level, it is very easy to distinguish between quantitative and qualitative research. Punch (1998) provides a rather simplistic approach when he refers to quantitative research as empirical research where the data are in the form of numbers, and qualitative research where the data are not in the form of numbers. This can be extended to refer to approaches to research. Henderson (1990) summarises the characteristics of the two approaches in table 6.1.

Table 6.1: Quantitative and Qualitative Approaches to Research

	Quantitative	Qualitative
Design characteristics	Pre-ordinate design	Emergent design
Data	Measurement using numbers	Meaning using words
Setting	Impersonal, controlled, manipulative	Natural, interactive, personal
Relationship with theory	Confirming theory	Developing theory
Process and procedure	Rational	Intuitive

Source: Finn et al (2000)

Much leisure and tourism research involves the collection, analysis and presentation of statistical information. Sometimes the information is innately quantitative and it is sometimes qualitative in nature yet presented in a quantitative form.

The quantitative approach to research involves statistical analysis. It relies on numerical evidence to draw conclusions or to test hypotheses. To be sure of the reliability of the results, it is often necessary to study relatively large numbers of people and to use computers to analyse the data. The data can be driven from questionnaire surveys, from observation involving counts or from secondary sources.

The qualitative approach to research is generally not concerned with numbers. It involves gathering a great deal of information about a small number of people rather than a limited amount of information about a large number of people. The information collected is generally not presentable in numerical form.

The methods used to gather qualitative information include observation, informal and in-depth interviewing and participant observation.

While the debate between protagonists of qualitative and quantitative research can become somewhat partisan, it is now widely accepted that the two approaches complement one another. Thus quantitative research is often based on initial qualitative work.

6.3.1 COMBINING METHODS

Philip (1998) argues that quantitative research is always associated with the hypothetico-deductive method of theory testing, and qualitative data with seeking patterns in the data to inductively generate theory. Evidence from leisure and tourism research would tend to support this, as there is a relationship between the purpose of the research and method of data collection. But this is not set in tablets of stone. Methods using quantitative data can be used to generate hypotheses and develop theory, and qualitative research can be used to test hypotheses.

What emerges from the previous discussion on these two approaches is that quantitative and qualitative methods have their strengths and weaknesses. It is highly likely that a researcher using quantitative methods will mix quantitative methods by using a questionnaire survey and published statistics. The same would be true of a qualitative researcher, mixing observation with in-depth interviewing. An argument could be put forward to support combining the two approaches to maximise the strengths and minimise the weaknesses of each method, which is the case in the current research. The assumption is that quantitative and qualitative methods are complementary rather competing approaches.

Henderson (1990) points out that combining methods seems to be a strategy that will enhance the research findings. Multiple methods appear to be preferable to single research methodology.

6.4 THE RESEARCH PROCESS

To do research is to be involved in a process. A process can be seen as a series of linked activities moving from a beginning to an end. The research process is not a rigid process, in which step A must be done and completed before step B can begin. On the other hand, there is a sense in which, if the first steps are not executed carefully, the rest of the research process will be rendered invalid, weakened or simply made more difficult.

According to Veal (1997), the research process can be divided into eight main elements. However, the enormous variety of approaches to research suggests that not all research projects follow precisely the same sequence of procedures. In practice, there is no overall consensus about the stages to be followed during research (Robson, 1993). Different models have been proposed by many authors (e.g. Oppenhim, 1992; Arber, 1993; Ryan, 1995; Pizam, 1994), each containing similar steps.

As figure 6.1 indicates, this research has adopted the eight steps process proposed by Veal (1997):

1. Formulation of the research problem;
2. Review of the literature;
3. Identification of aims and objectives;
4. Decide research questions;
5. Research design;
6. Selection of data collection techniques;
7. Selection of subjects;
8. Planning of Data processing and analysis.

It is possible to group the eight steps into four major stages of research:

1. The essential first steps (steps 1 to 4);
2. Research design (step 5);
3. Data collection (steps 6 and 7);
4. Analysis and interpretation (step 8).

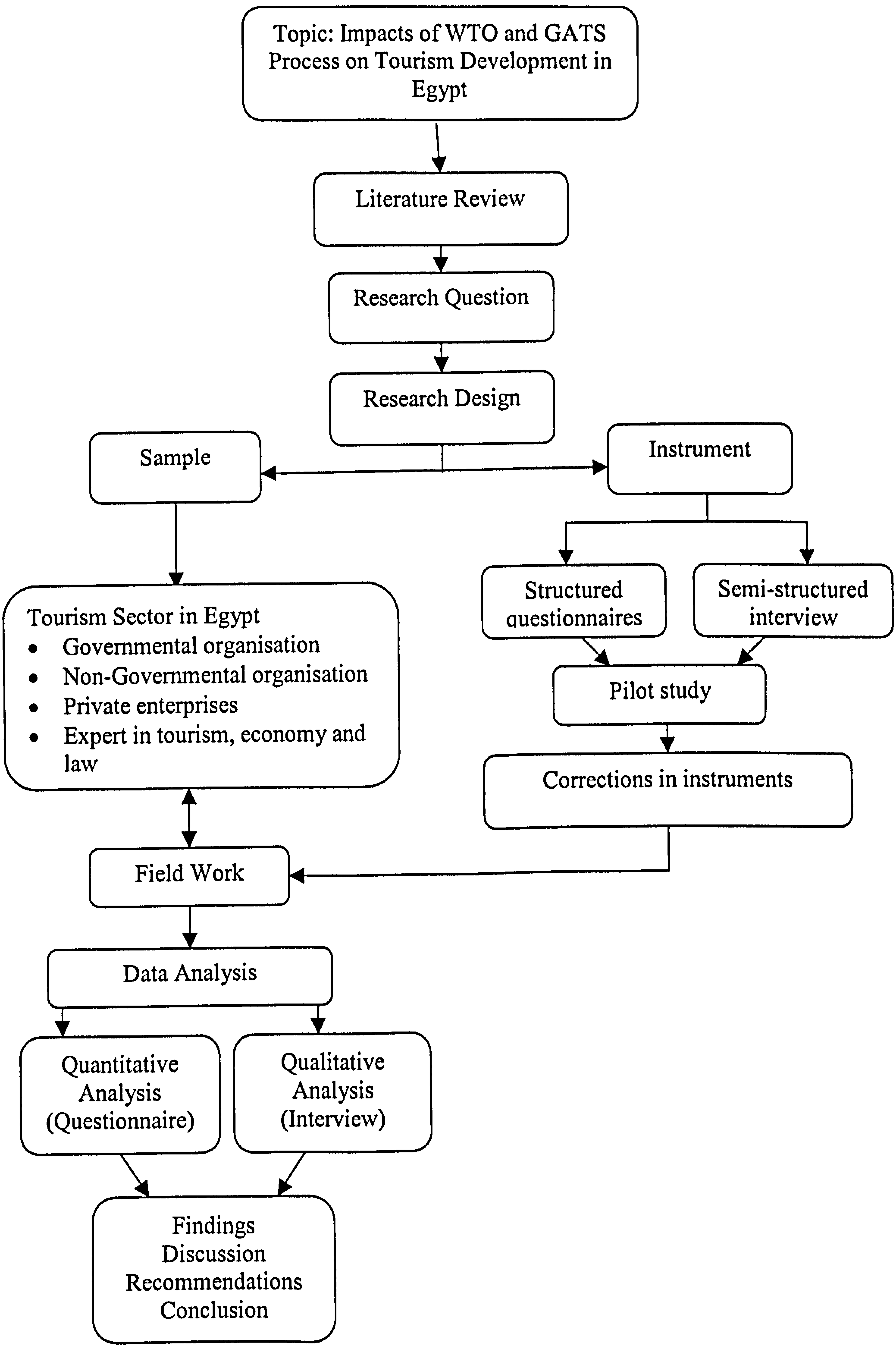


Figure 6.1: Procedure Flow of the Research

6.5 THE ESSENTIAL FIRST STEPS

Phase one of the research process involves four essential first steps. These steps are essential because failure to address these issues satisfactorily will undermine, or make more difficult, the rest of the research process. It is one of decision-making, sorting narrowing, and clarifying ideas. It requires clear thinking and involves selecting a research problem, reviewing of the literature and narrowing the focus of the question (Pizam, 1994).

The goal of this step in the research process is a clear statement of the issues to be studied. One form of such a statement is the research hypotheses, other forms include the research questions and objectives. The hypotheses, research question and objectives are all precise, narrowly focused statements.

The first step to follow to narrow and clarify a problem question is to formulate the research problem, by listing the issues involved in the question, then choose from that list a question that will focus on a narrowed problem.

A second step to narrow and clarify a question is to consult what has already been written about the topic; this is called reviewing the literature.

After isolating factors and issues, and reviewing the literature, the third step is to restate the issue as a researchable question, hypothesis and objectives (see figure 6.2).

The Essential First Step

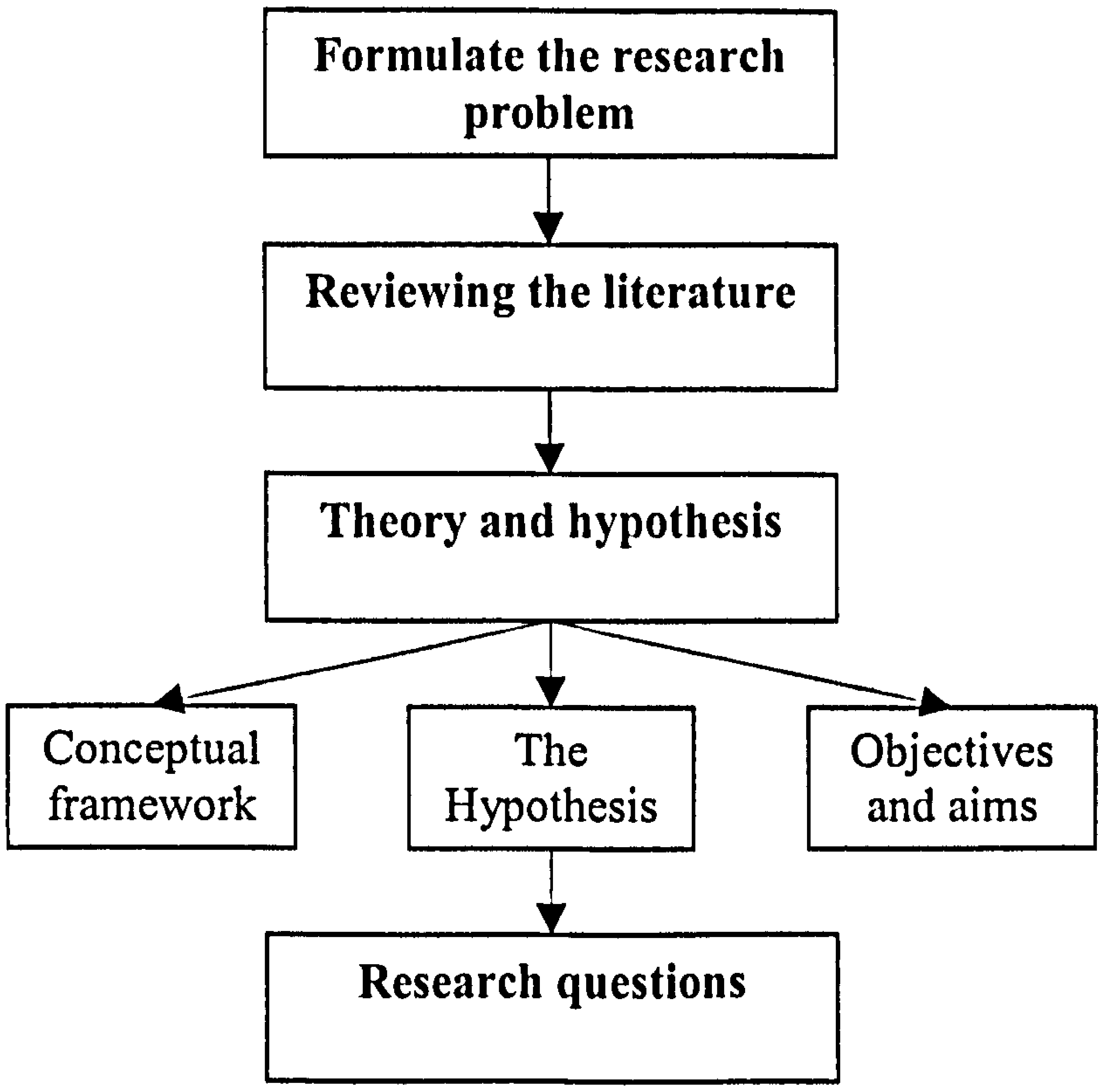


Figure 6.2: The Essential First Steps for Research Process

6.5.1 FORMULATION OF THE RESEARCH PROBLEM

6.5.1.1 The Process of the Research Problem Development

The first step of the research process is to select a research problem, according to Dixon et al (1987), a specific topic may arise from a range of sources, which include:

- The researcher's personal interest, which is generally a starting point in selecting a topic;
- Issues identified in the literature;
- A policy or management problem;
- An issue of social concern; or
- A popular media issue.

In this research, the research problem was developed from the following evidence and observations:

1. Tourism is regarded as the world's largest fastest growing industry and highly labour intensive both in developed as well as developing countries. Tourism ranks in the top five export categories for 83 percent of countries (WTO/OMT, 2000). In addition to its growing share in services and GDP, tourism's role in the world economy is expected to grow even further in the next couple of decades.

2. Economists tell us that free trade is superior to no trade. The theory of comparative advantage says that countries prosper first by taking advantage of their assets in order to concentrate on what they can produce best, and then by trading these products/services for products/services that other countries produce best. In other words, liberal trade policies multiply the rewards that result from producing the best products, with the best design, at the best price.

3. But success in trade is not a static event. The ability to compete well in particular products can shift from company to company when the market changes or new technologies make cheaper and better products possible. Furthermore, competitiveness can also shift between whole countries. A country that may have enjoyed an advantage because of lower labour costs or because it had good supplies of some natural resources, could also become uncompetitive in some goods or services as the economy develops.

4. The Uruguay Round was the largest negotiation in world economic history and resulted not only in a continuous process of trade liberalisation, but also the development of a strong rules-based multilateral trading system. Among the results of the Uruguay Round, the most important are the establishment of the World Trade Organisation (WTO) (1995b) and the General Agreement on Trade in Services (GATS).

5. GATS is the first multilateral enforcable agreement to cover trade in services.

6. The guiding philosophy of the GATS is that the easier it is for companies to compete and to do business, the more trading results and the more economies grow for the benefit of all trading countries (WTO, 1995a).

7. GATS covers travel and tourism industry. The WTO (1998g) states that Tourism and Travel Related Services (TTRS), category 9 of the Services Sectoral Classification List of GATS, is distinctly limited in scope. The category is divided into four sub-sectors:

   - Hotels and restaurants (including catering);
   - Travel agencies and tour operators services;
   - Tourist guides services;
   - Other.

8. There were dissenting opinions with respect to the impacts of the WTO and the GATS on the member countries developed and developing alike. It has been said that the WTO and GATS are just an instrument used by the developed countries to impose their domination on the economies of the developing ones. As regards tourism, the GATS opens the door to the gigantic international tourism companies to break through the developing countries' market and to overwhelm the tourism industry there.

9. In 1995, Egypt, as the study area, joined the membership of the WTO and the GATS. It committed itself to approve the terms and conditions of the WTO and the GATS. Egypt signed for the tourism sector in the GATS, which will affect tourism development in Egypt.

10. Tourism has grown rapidly in Egypt over the last decade. It is one of the most important industries for the economy. Adding the indirect effects of the industry, in 2000, the total contribution to output reached $9.6 billion (11.6 percent of GDP) (Tohamy and Swinscoe, 2000).

11. Despite the importance of the tourism sector to the Egyptian economy, the tourism industry in Egypt is fragmented and has not been developed enough yet. Tourism policy (governmental institution policy or non-governmental organisation policy) is not clear and is not effective.

12. Furthermore, the tourism supply sector in Egypt is highly fragmented and characterised by a large number of SMEs. In their business relations with tour operators, many suppliers of tourism services in Egypt (hotels, travel agencies, tourist guides, land-transport providers) are hampered by their weak bargaining position and their lack of negotiating skills, which often result in unfavourable contractual conditions. Moreover, they face fierce competition from large companies, including those with foreign capital participation, which resulted in sharp decreases in prices and lower quality services that negatively affect local service providers in developing countries in general and in Egypt.

6.5.1.2 The Problem

Given that Egypt signed the GATS agreement and opened the tourism market to foreign competition, it is no longer enough for policy makers and the supply sector to consider their policy in isolation from global market policy. They need to acknowledge that liberalisation has the inherent potential to affect not only their policy but also their business as well as tourism development in Egypt. Their ability to compete successfully within a global trading system will depend upon:

- Their ability to strengthen their capacity to produce internationally competitive services;
- The extent of liberalisation in the tourism related sectors of export interest to them.

Furthermore, the potential impacts of GATS will depend on good organisation during the transitional period (2000-2005) at the governmental level represented in the ministry of tourism and its affiliated institutions, the non-governmental level, and the private sector level.

Given the above, there is a clear need to understand, explore and analyse the impacts of the GATS and WTO processes on tourism development in Egypt, taking into account the characteristics of the tourism industry in Egypt and the level of development in the country.

6.5.2 REVIEW OF THE LITERATURE

"Reviewing the literature is an academic term referring to the process of identifying and engaging with previously published research relevant to the topic of interest" (Veal, 1997, p.43).

An important part of academic research is a review of the literature. Identifying relevant literature is therefore a demanding but essential task. It involves a careful search for information on relevant published work and, if accessible, unpublished work.

The aim of academic research is to add to the body of human knowledge. To presume to add to that body of knowledge it is therefore necessary to be familiar with it and to indicate precisely how the proposed or completed research relates to it.

Preece (1994) argues that while clarifying and narrowing the research question, the researcher should at some point consult the literature available on the subject. The key at this point in the research process is to identify issues, to select from all that is involved in a specific issue or question that the research will pursue in depth. The process can play a number of roles:

- Entire basis of the research;
- Source of ideas on topics for research;
- Information on research done by others;
- Source of methodological or theoretical ideas;
- Basis of comparison;
- Information that is and integral/ supportive part of the research.

Reviewing the literature for a research purpose involves reading literature in a certain way. It involves being concerned as much with the methodological aspects of the research as the substantive content. That is, it involves being concerned with how conclusions are arrived at as well as with the conclusions themselves. It involves being critical - questioning rather than accepting what is being read. The task is as much to ascertain what is not known, as to determine what is known (Black, 1994).

As material is being read, a number of questions might be asked (see box 6.1) the questions relate to both individual items and the body of literature as a whole.

Box 6.1: Questions to Ask When Reviewing the Literature

(a) Individual items

- What is the (empirical) basis of this research?
- How does the research relate to other research writing on the topic?
- What theoretical framework is being used?
- What geographical area does the research refer to?
- What social group(s) does the research refer to?
- When was the research carried out and is it likely still to be empirically valid?

(b) In relation to the literature as a whole

- What is the range of research that has been conducted?
- What methods have generally been used and what methods have been neglected?
- What, in summary, does the existing research tell us?
- What, in summery, does the existing research not tell us?
- What contradictions are there in the literature - either recognised or unrecognised by the authors concerned?
- What are the deficiencies in the existing research, in substantive or methodological terms?

Source: Veal (1997)

For this research, various sources were used to provide information on:

- The tourism industry;
- International trade theory (comparative advantage);
- International trade policy (protectionism);
- Globalisation;
- Liberalisation;
- World trade organisation (terms, conditions and implications);
- GATS (principles, implication for tourism sector);
- Egypt as a study area.

This information helped the researcher to identify the control variables and to explore the relationship among the variables.

6.5.3 THEORY AND HYPOTHESIS

6.5.3.1 Theory

The starting point for the process is a theoretical domain. Theory is used as a guiding framework to help explain and understand the research findings, and indicate the types of conditions under which the research has taken place. Theories are conceptual frameworks to help make sense of the research findings. It is important to appreciate that theory and empirical evidence are linked through the research process (Bryman, 1989).

There are many different types of theories. Grand theories attempt to explain macro changes in society, and may be fairly abstract. They include theories of deindustrialisation, globalisation, Fordism and post-Fordism. Each of these grand theories has relevance to the study of tourism (Finn et al, 2000).

It is unlikely that a student researcher would attempt to seek evidence to verify or reject these theoretical constructs. Rather they are more likely to determine the context of the research or form the broad framework to influence the questions the researcher wants to answer.

Emphasis has been given to the link between theory and research. Research needs a theory as a framework for analysis and interpretation, and theory needs research to constantly review / modify / challenge theoretical details.

Two different methodological approaches to theory have been identified, one of which tests theories, the other generates theory (Pizam, 1994).

The theory testing approach (deductive) is usually associated with quantitative data, whereas the theory construction approach (inductive) is more commonly associated with qualitative data. This is not say that qualitative data cannot be used with a deductive approach and qualitative data with an inductive approach.

With the deductive approach (testing theory), the researcher begins with the theory and collects empirical evidence to analyse with a view to either accepting or refusing the theory. Theorising comes before the research enquiry.

Before the research process associated with the deductive approach is examined in more detail, some basic terms need defining. Finn et al (1998) define the basic research terms in the following way:

1. **Theory:** a set of concepts used to define and/or explain some phenomenon.
2. **Model:** an overall framework for examining reality.
3. **Concept:** an idea deriving from a given model variable: unit of analysis that represents features that are changeable.
4. **Variable:** unite of analysis that represents features that are changeable.

The deductive approach begins with theorising and the identification of key concepts derived from the theory. These concepts have to be defined more specifically before hypothesis can be set up to test.

Concepts have been operationalised and defined to become variables, so that they can be analysed. Figure 6.3 shows the process of deduction.

Main Stages

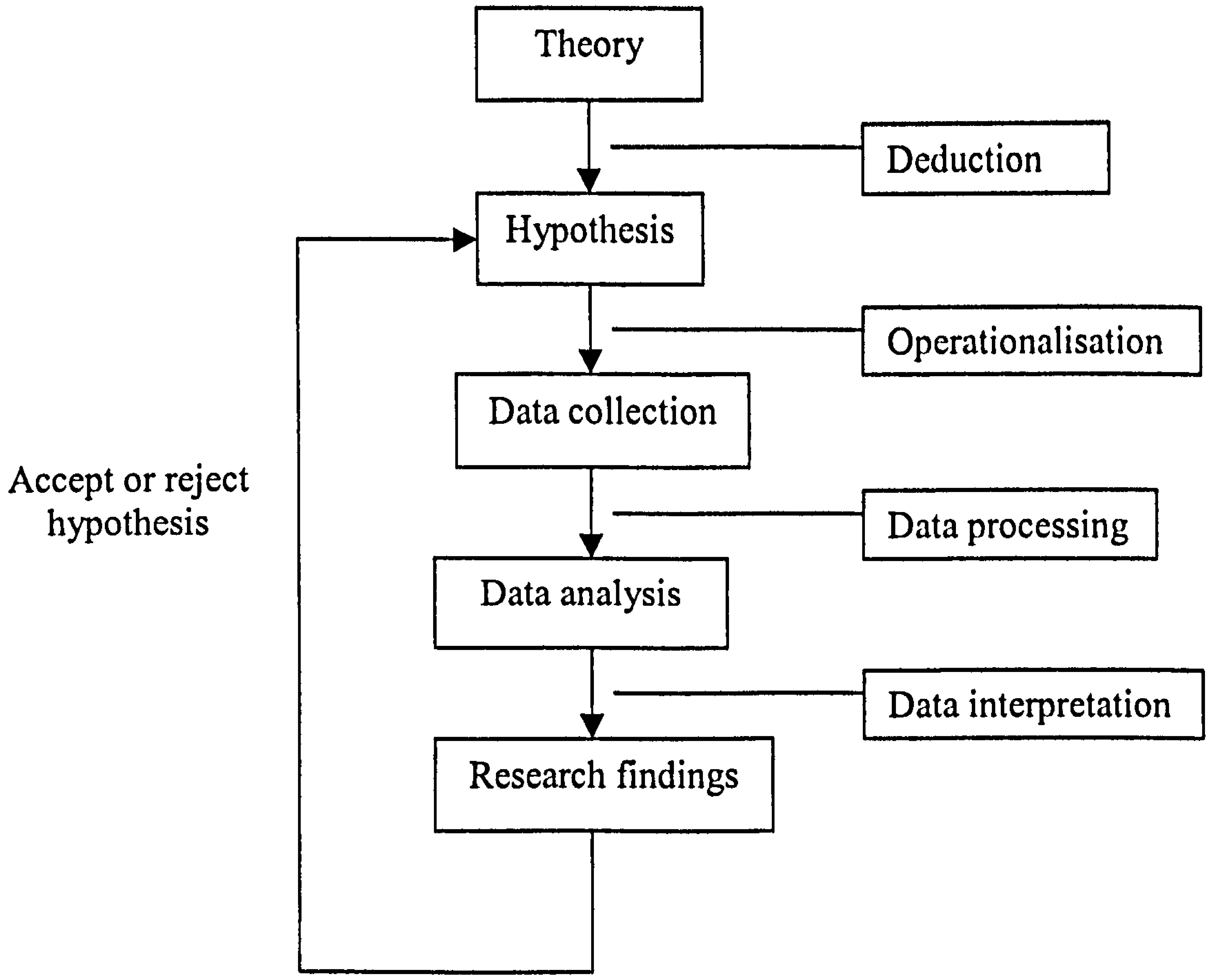


Figure 6.3: The Structure of Hypothesis Testing Approach

The flowchart begins with the theory, and from that theory, a number of concepts are identified which form the basis of the research. The concepts identified are then set out as a serious of hypotheses, which will be tested by collecting data. The hypothesis is the key element in this deductive approach. In simple terms, a hypothesis is a proposition that is presented in a testable form. It is a statement that predicts the relationship between two or more variables. Before the hypothesis can be tested the concepts are operationalised into variables/indicators that can be measured in quantitative terms. Data are then collected, analysed and the hypotheses are either accepted or rejected (Finn et al, 2000).

If accepted, then the theory is assumed to be corroborated by the empirical evidence as a valid explanation. These are known as 'covering law explanation' because the variables that are explained are covered by the assertions about those phenomena in the theory. These "covering law explanation" where relationships have been established between variables not only explain past events but can also be used to predict future observations.

In contrast, to the deductive approach, induction involves researching a particular aspect of tourism and leisure and attempting to derive theories from the data produced. The research proceeds the theorising. This is a theory-building approach to research, or more simply, theory is the outcome of induction. The rationale behind this approach is that explanations must be grounded in observations and experience to be of value. This approach to research developed out of criticism of positivism arguing that positivism was an inappropriate method of researching social science phenomena in disciplines like leisure and tourism (Black, 1994).

The inductive approach is associated with a philosophical tradition that argues that the world is socially constructed and is given meaning by people. The researcher should be clear about what should pass as knowledge about the world of leisure and tourism - philosophical.

6.5.3.2 Devise Conceptual Framework

Once a theory has been formulated, it is important for the researcher to develop a conceptual framework. The development of the conceptual framework is arguably the most important part of any research project and also most difficult. According to Bryman and Cramer (1999), the conceptual framework involves concepts. A concept is an idea that stands for something, or represents a class of thing. They are general representations of the phenomena to be studied - 'the building blocks of a study'.

A conceptual framework indicates how the researcher views the concepts involved in a study- in particular the relationships between concepts. Thus the development of a conceptual framework involves four elements:

(a) Identification of concepts;
(b) Definitions of concepts;
(c) Exploration of relationships;
(d) Operationalisation of concepts.

Identification of concepts is usually the starting point, but the exercise is generally iterative, that is, it involves going backwards and forward, or round and round, between the various elements until a satisfactory solution is reached (see figure 6.4) (Veal, 1997).

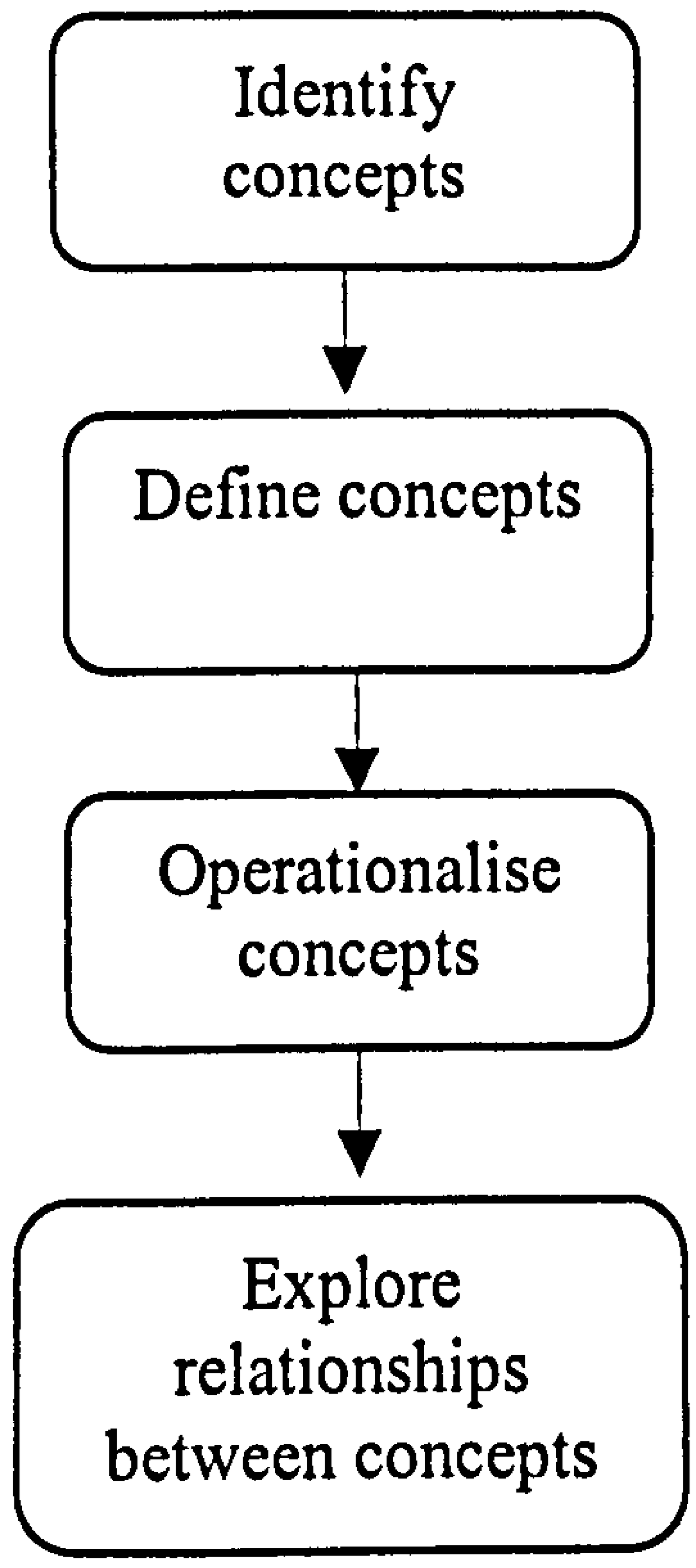


Figure 6.4: Development of Conceptual Framework

In order to assess the validity of a hypothesis it is necessary to develop measures of the constituent concepts. This process is often referred to as operationalisation. In effect, what is happening here is the translation of the concepts into variables; that is, attributes on which relevant objects differ.

As figures 6.5 shows, the operational definition of the key elements of the current research are:

GATS: the level of liberalising trade in tourism under GATS is measured by evaluating the Egypt specific commitments that have been undertaken in the market access and national treatment with respect to the four modes of supply:

- Cross border;
- Consumption abroad;
- Commercial presence;
- Personal mobility.

Tourism Policy: this is to identify Egypt's policy options regarding liberalisation of the service and tourism sectors, within the frameworks of similarities and differences of the tourism policy in Egypt in the governmental and non-governmental organisation.

Tourism Supply Sector: the impacts of the GATS on the supply sector are measured by determining the characteristics of the tourism supply sector in Egypt and to what extent they could compete in a more liberalised market. This is within frameworks of evaluating their policy options towards liberalisation, obstacles that currently face their business, and the impacts of tough competition on their business using two main analytical frameworks: profitability and employment.

Economic Impacts of Tourism: this is measured by examining to what extent the GATS will affect the tourism revenue in Egypt, by looking at:

- Tourism numbers;
- Out put;
- Value added;
- Employment;
- Taxes revenue.

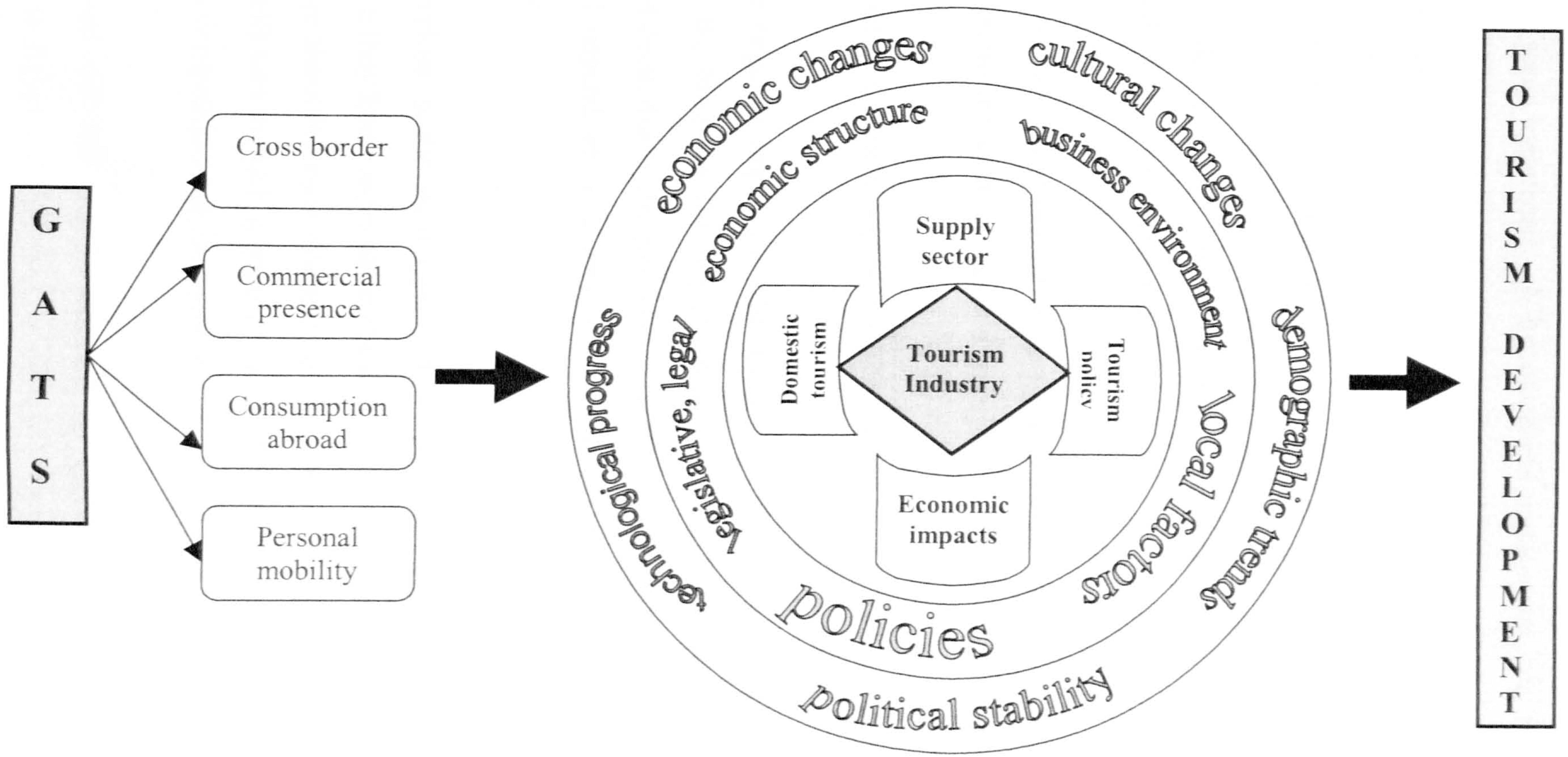


Figure 6.5: Concept Map

6.5.3.3 The Hypothesis

Having identified the research conceptual framework, it is important for the researcher to form some hypothesis. A hypothesis is a statement, which asserts a relationship between two or more concepts. Bryman and Cramer (1999) also defined a hypothesis as a specific statement of prediction. It describes in concrete (rather than theoretical) terms what you expect will happen in a study. The research has adopted these hypotheses to be investigated:

- The GATS schedule of specific commitments of Egypt needs to be modified and some area needs to be more liberalised.

- The tourism legislation and regulation in Egypt will be changed to fit with the new trading system and with the Egypt schedule of specific commitments.

- The tourism policy will be changed in a more flexible and effective way.

- There will be negative impacts on the tourism supply sector, especially in the short run. In the long run the impacts might be different and some positive impacts would occur due to the learning curve from the competition. At the same time this will depend on how long it will take for the company to turn the learning curve.

- The guide services in the short term will survive foreign competition, this is simply because they know more about the culture, more familiar with the system, and know more about the country's background. But the learning curve from the competition will turn around in time to be the foreign suppliers' side, who will learn from the competition and can compete more effectively.

- As liberalisation will increase the demand for travel, it is expected that the tourism flow to Egypt will increase, at the same time the average of stay will decrease, this is because of new trend all over the world to include more than one country in a trip. This issue becomes more important in the Mediterranean region.

- In terms of tourism revenue it is assumed that the tourism revenue will decrease because of the changes in the average length of stay and more important because of the leakage of capital investment, which will affect directly the Egyptian economy. This will differ in the long and short run.

- Many foreign suppliers will be interested to expand business to Egypt, because of the cheapness of labour (the comparative advantage that the country holds) and the importance of the country as a tourism destination area.

6.5.3.4 Aims and Objectives

The general aim of this research is to examine and analyse the terms, codes and practice of the WTO and the GATS and their implications for tourism. This examination may be used to complete our understanding of how the system works and help governments exploit the system to their own advantage, especially in the developing countries, in the negotiations and the implementation of the agreements.

Furthermore, the fundamental purpose of this research is to examine the impacts of the liberalisation brought about GATS and WTO on tourism development in Egypt; by analysing the factors that influence tourism development in Egypt, i.e., the tourism policy, tourism legislation/regulation, the supply sector and the tourism numbers and tourism revenues. The results will be used to adopt a new generation policy for tourism for both governmental and non-governmental organisations.

The general and the fundamental purpose of the research led to the formulation of more specific objectives:

1. To determine the characteristics of the tourism sector in Egypt and its GATS commitments in order to indicate how Egypt is similar to, or different from, other WTO countries and to evaluate to what extent Egypt has liberalised the tourism sector.

2. To examine the impacts of GATS and WTO on tourism legislation and regulations in Egypt.

3. To measure the effectiveness of current tourism policy in Egypt and how it could be changed to maximise the benefits of GATS and minimise the weaknesses. This is done within the framework of similarities and differences between tourism policy in Egypt in the governmental and non-governmental organisations. The results can be used to identify the weaknesses and the strengths, if any, in the current tourism policy.

4. To examine the impacts of liberalisation on the tourism supply sector in Egypt in the short and long run in order to help the supply sector overcome the negative impacts of tough competition in the foreign supply sector. In order to do this the study will examine the characteristics of the supply sector in Egypt and identify its comparative advantage. The results can be used to identify the difficulties and problems that face the supply sector in Egypt. Furthermore, some recommendations for the supply sector to help them overcome problems will be made.

5. To analyse the impacts on tourism flow and tourism revenue in Egypt. The results can be used to appreciate the economic impact of tourist expenditure on the Egyptian economy, this means taking into account the leakage of tourist expenditure (paying for foreign investment) after the GATS.

6.5.3.5 Research Questions

Formulating a good research question can reasonably be thought of as one of the most important steps in the research process, and it certainly is not the easiest. There are no set rules or stages for developing a good research question.

This research aims to analyse the terms and codes of the WTO and the GATS and their implications for tourism, as well as examining the impacts of liberalising trade in tourism on the tourism development of Egypt.

As extensively discussed in chapters 2, 3 and 4, the comparative and competitive advantage of the country is one of the most decisive elements in determining the gains from free trade. An understanding of the sources of comparative advantage in the tourism sector in Egypt will help to determine the potential gains from the WTO and the GATS. This evidence along with the importance of the tourism sector in Egypt and the fact that Egypt committed itself to liberalising the tourism industry through GATS led to the research question:

What is the impact of liberalising trade in tourism on tourism development in Egypt in the short and long term?

This question led to subsidiary questions, which helped the researcher to focus the topic and determine what exactly needed to be investigated:

1. How important is the service sector in general and the tourism sector in particular to the Egyptian economy?

2. What are the main tourism liberalisation policies and how effective are they?

3. What are the obstacles that face the supply sector, local and foreign investment?

4. What are the motivations for signing the GATS and the WTO?

5. What are the main features of Egypt's GATS commitments?

6. What are the preparations for the GATS in the next two years?

7. How far do the government and supply sector understand how to use the GATS to achieve their business goals?

8. What are the most important GATS modes of supply that could affect the tourism supply sector?

9. What is the future of the tourism supply sector in Egypt in the short and long run?

10. What are the impacts of GATS on tourism flow, revenue, and average length of stay in Egypt?

6.6 RESEARCH DESIGN (IDENTIFYING THE PURPOSE)

Having identified the specific research questions and established adequate operational definitions of concepts, the researcher is now in a position to select possible research designs and methods of data collection, which can be used to obtain the data to address the research question.

6.6.1 RESEARCH TYPES

There are essentially three main types of research design:

- Descriptive research;
- Explanatory research (analytical research);
- Evaluative research.

Descriptive research is designed to identify the characteristics of a specified population, either at a given moment in time, or over a period of time. The key consideration in the descriptive survey is the representativeness of the data obtained. As a key objective is to be able to generalise from the findings to the specified population, the sampling method assumes importance.

Explanatory research (analytical research), seeks explanations for observed variations in given phenomena. Analytical research may be inductive or may be designed to test specific hypotheses. A key difference between descriptive and analytical research is that in the latter the independent and dependent variables need to be identified before hand. Thus, in explanatory research, the literature search is much more important as this provides the background information necessary for the identification of key variables. Therefore, it is particularly important that all variables are identified and operationalised. Conceptualisation of the research problem prior to implementation is crucial in explanatory research and this is facilitated by a thorough review of the literature.

Evaluative research arises from the need to make judgements on the success or effectiveness of policies or programmes. It is highly developed in public policy, for example, education, but is less developed in the field of leisure and tourism (Howell and Badmin, 1996).

The current research adopted the three types of research design. According to the objectives of this research, the research seeks to discover, describe and explore the attitudes towards tourism liberalisation, which would help to adopt a new set of tourism policy. Explanatory research moves beyond describing the attitudes of respondents to explain the patterns and trends observed. This requires the researcher to be rigorous in the collection, analysis and interpretation of data. Once causes are understood, the knowledge can be used to predict. In this study many variables have been studied to predict the impacts of GATS on tourism development in Egypt.

Evaluating research arises from the need to make judgements on the success of effectiveness of policies. This is the case in this research, which trying to evaluate the current tourism policy in Egypt and Egypt's GATS commitments.

6.6.2 RESEARCH STYLE

Many texts on research methods make the distinction between three different styles of research:

- Survey method;
- Experimental method;
- Ethnographic method.

The survey requires a sample of respondents to reply to a number of questions that have been preciously determined as relevant to the research. By using the same questions for the selected sample of respondents, individuals in the sample may be compared. Data may be collected through an interviewer-administered questionnaire or a self-completion questionnaire. The survey has the advantage of collecting a lot of information in a relatively short period of time. The survey can be used deductively by testing hypotheses, or inductively by looking for patterns in the data. It is the most common type of research style used by researchers in leisure and tourism (Birley and Moreland, 1998).

Experimental research is less common in leisure and tourism research. The experiment involves testing variables under controlled circumstances to measure the effect of one variable on another. In the experimental research design, the independent variable is manipulated to find out its impact on the dependent variable. This is achieved by setting up an experimental group and a control group, and treating one group differently from the other. With a well-designed experiment, all other variables that could affect the outcome of the research are controlled for and eliminated, to make it easier to connect a cause (independent variable) with an effect (dependent variable). This type of pure experimental research is difficult to carry out in tourism and leisure research (Veal, 1997).

Ethnographic research involves a method of investigation where a cultural change is observed in its natural setting. Ethnographic research studies the complexity of social interaction as expressed in daily life. Focus is on the meanings participants attribute to these interactions (Marshall and Rossman, 1999). The emphasis on naturalism is one of its main advantages of the method. It is also time-consuming, and this is one of the disadvantages.

The research adopted the survey method as the most appropriate research instrument for satisfying the research goals.

6.6.3 SURVEY BASED RESEARCH

Smith (1995: 42) claimed that " surveys are, arguably, the most important source of information for tourism analysis, planning and decision making". Survey research involves asking participants questions either as part of a face-to face interview, by telephone interview or by post. The normal survey tool is a series of printed questions in the form of questionnaire or interview schedule. The purpose of the questionnaire is to obtain reliable and valid data on the most subject being researched. The most distinguishing feature of survey research is probably the size of the sample or the number of participants involved. Surveys are usually large scale.

A key objective of survey research is to obtain data that is representative of the population. In other words, research based on surveys is usually used to generalise from the sample to a larger population. Consequently the issue of sampling is an important one.

Moser and Kalton (1989: 4) argues that any definition of the survey would have to be "so general as to defeat its purpose, since the term and the methods associated with it are applied to an extraordinary wide variety of investigations". The survey can be regarded as a structure, in which methods of data collection are employed. It involves:

- Collection of data (invariably, but not exclusively, by self-administered questionnaire, structured or semi-structured interview);
- A given set of units (sampling) (people or organisation);
- Systematically obtaining quantifiable data on pre-determined variables, which are then analysed.

Therefore, the survey is normally a means of collecting quantitative evidence. The design and execution of any survey must proceed in a systematic and logical manner. The pre-testing and piloting of a survey is important as designing questions. The success or failure of a survey is essential determined by the response rate or the percentage of the total number of people surveyed who responded.

An essential prerequisite of survey design is to know what kind of information is needed, to describe the parameters of the population or to test hypotheses and analyse variance. It is imperative that the research topic is thoroughly conceptualised and that existing literature is consulted. Finn et al (2000) argues that design and implementation of the questionnaire should follow an appropriate review of the literature. Like any research design, a survey is designed to answer .particular questions or to illuminate particular subject areas. Survey designs pre-suppose that the research questions have been pre-determined.

6.7 DATA COLLECTION TECHNIQUE

6.7.1 RESEARCH INSTRUMENT

There are a number of different ways of conducting a survey; each has costs and benefits. There is no cut and dried solution to any single research problem since the purpose of the research; the participants and resources available will vary from project to project. The survey method uses either a structured or semi-structured interview or questionnaire. A key aspect of the survey is that each respondent is presented with the same question in the same manner, so producing standardisation and control. A questionnaire can be used in several ways: oral questions with answers filled in by the interviewer (either face to face or by phone), answers completed by the person being interviewed or sent by post and completed by the person and either returned by post or collected individually (postal questionnaire).

6.7.1.1 Postal Survey

Distributing questionnaires by post is a kind of self-administrated survey, since respondents complete the questionnaire on their own. The post survey is relatively inexpensive, not very-time consuming and often a highly effective and quick means of reaching a specific sample. The self-completion questionnaire has the advantage that it may be completed in privacy, but the likelihood of misunderstandings and incomplete questionnaires is increased. Nonetheless, the technique lacks one important ingredient - that of the interviewer. Consequently, instructions are important in postal surveys since there are no opportunities to clarify inconsistent responses.

The postal questionnaire has a number of further disadvantages. The response rates are often very poor. The researcher can never be sure whether the right person filled in the questionnaire. Since many participants will examine the questionnaire before responding, answers will not be spontaneous and may not be independent. The format is clearly limiting - questions must be simple, as there is no opportunity to probe further.

6.7.1.2 Telephone Surveys

The telephone survey is an alternative survey method. Generally, the method has the advantages of being cheap, the physical appearance of the interviewer does not matter and the potential sample size is huge. However, the response rate can be low, it introduces bias to those who have telephones, and it is only suited to a small number of questions; certainly the interview should last no longer than 15 minutes.

For the purpose of this research, the postal and telephone surveys were not adopted as a survey instrument, and it was decided to utilise the face-to-face interview.

6.7.1.3 Face-to Face Interviews

Face-to face interviews are essentially structured conversations, or question and answer sessions. The conversation is structured by a schedule of questions, which is administered by an interviewer to every respondent in the same way. Face-to face contact between participant and researcher is one of the reasons for generating high response rates. The researcher should establish who is to be approached and how; this is done through a set of procedures which are used throughout the survey.

The implementation of the interview schedule is vitally important. The interview should be efficient and effective. It should be structured and questions should flow in a logical order. When asking open questions, the interviewer should record the answer as accurately as possible and seek clarification of ambiguous answers where appropriate.

The interview can introduce many sources of bias into the research and thereby undermine the reliability of the research instrument. The respondent will make available only the information, which they think, will be of interest. This is known as the interview effect and is inevitable to some extent.

Interviewer bias has long been recognised as a potential problem for this style of research. Firstly, the attitudes and opinions of the interviewer may affect the replies to certain questions. Secondly, it is possible for the interviewer to misrepresent the respondent or the interviewee to misunderstand the question. Thirdly, the ethnic origin, religion, age and social class of the interviewer or interviewee can introduce bias. Fourthly, the interviewer can influence replies to questions by changing tone of voice or facial expression, by putting answers into the respondent's mouth. However, many of these problems can be avoided if adequate training is given to the interviewer and by providing appropriate instructions on the interview schedule.

6.7.2 DESIGNING THE RESEARCH INSTRUMENT: THE QUESTIONNAIRE

Any survey must have a focus, or a central issue to which most items in the survey are related. This focus depends upon the purpose of the research. Each item must have a good reason for inclusion in a survey. The final questionnaire or interview schedule reflects the manner in which the research problem or focus has been operationalised. Survey questions are a means of measuring or obtaining information on the key concepts within the research. So the design of questions involves a staged process:

- Define the concept;
- Break the concept;
- Develop indicators for each dimension;
- Select one or more indicators for each dimension;
- Design question to collect information for each indicator;
- Pre-test the questions in order to ensure that they are valid and reliable;
- The resultant questions from the variables in your data analysis.

The questions should reflect the objectives of the research. They should relate to the research hypotheses, key indicators and should be arranged so that the questionnaire flows in a logical manner.

There are two types of question in questionnaire - open ended and closed questions. Closed questions have pre-coded answers, whereas in open ended questions respondents are encouraged to express themselves more freely.

The advantages of closed questions are that they are easy to analyse and quick to answer. The disadvantage is that the respondent may be forced into an answer, which only approximates what they want to say. Open-ended questions are particularly useful in determining a respondent's feeling on a topic or for identifying the reasons why they hold particular points of view. Open-ended questions are better at determining how strongly views are held and opinions on specific aspects.

The current research includes the two types of questions (closed and open-ended). For closed questions, several formats are used to examine attitudes and opinions of respondents, for example, ranking, likert scale and attitude statements.

The research objectives imply that this research has two stages, the first is to examine and analyse the terms, codes and practice of the WTO and the GATS and their implications for tourism. The second stage of this research is to examine the impacts of the liberalisation brought about GATS and WTO on tourism development in Egypt. Choosing appropriate research methods or techniques is clearly vital to achieve the research objectives.

6.7.2.1 First Stage: (Identification of Principles and Rules of WTO and GATS in Relation to Tourism Industry)

The WTO and GATS are multilateral agreements between trading nations. They provide a set of rules for the conduct of international trade and are the form in which worldwide negotiations take place. Therefore, they can be best identified through unwritten rules, assumptions, values and beliefs. Semi-structured interviews are used in this stage, that is a combination of structured and unstructured questions. The former is applied to identify the level of understanding of the agreement and its implication for the tourism industry and to identify the strengths and weaknesses of the WTO and GATS with regards to the tourism industry.

The decision to use a semi-structured interview gave the interviewer the freedom to adapt the research instrument to the level of comprehension and articulacy of the respondents. Cannon (1994) suggests that in using semi-structured interviews, the interviewer, while asking certain major questions the same way each time, is free to alter their sequence and to probe for more information. Thus, the interviewer was able to adopt the research instrument in accordance to the respondent's comprehension and articulateness, and to react to the fact that in responding to a certain question, respondents also provided answers to questions that would be asked later. All these gave the interviewer the chance to better achieve the research objectives.

Furthermore, for community studies, the semi-structured interview is the most appropriate technique to provide insights into how community groups think about complex issues (e.g. implementation of GATS). Additionally, interviews of community members can allow each participant group to have their views heard equally (Oppenhiem, 1992; Robson, 1993; Pizam, 1994).

Although the use of a non-structured interview could be considered for the purpose of this stage, it would have required an extensive and comprehensive relationship between the researcher and the subjects. However, this is not the case in the present research.

Interviews were tape-recorded for accuracy of analysis and validity of data. However, the researcher asked respondents' permission to tape-record interviews. Moreover, recording conveys the impression that responses are taken seriously, which made respondents more interested and involved in the interview.

6.7.2.2 Second Stage (Impacts of GATS on Tourism Development in Egypt)

As the objective of this stage was to measure the impacts of liberalisation on tourism development in Egypt, two approaches were required: one to measure the effectiveness of the current tourism policy in Egypt which would help the researcher to identify weaknesses and strengths, if any, of current tourism policy in Egypt.

The other is to examine the impacts of liberalisation on tourism supply sector in Egypt in the short and long run. To achieve the main objectives of this research, a structured questionnaire technique was used. Three structured questionnaires were designed; each questionnaire was divided into three main sections:

- International trade policy and tourism policy in Egypt;
- GATS commitments and its implications for tourism;
- Impacts of GATS on the tourism supply sector in Egypt.

The questionnaires were distributed to three main groups:

- Questionnaire one: Government;
- Questionnaire two: tourism private enterprises;
- Questionnaire three: tourism experts.

Veal (1997) suggests that questionnaire based survey are used when quantified information is required concerning a specific population. Furthermore, Punch (1998) points out that the structured questionnaire is a multi-variable survey, seeking a wide range of information. Given the nature of this stage, structured questionnaire was the most appropriate way to collect data. Thus the researcher was able to include measures of attitudes, values, opinions and beliefs as well as factual information.

The survey was face-to-face (interviewer completed). The interviewer provided the questionnaire script; read the questions out to the respondent and recorded the respondent's answers on the questionnaire.

Although, the interviewer completion questionnaire is more expensive in terms of interviewer time, it ensures a more accurate, consistent and complete response. Furthermore, it often results in higher response rates.

The researcher ensured that respondents were fully informed about the purpose and context of the research, about confidentiality, and about what use would be made, and by whom, of the information provided. By doing so, the response rate was very high and people were interested in co-operating, thus the quality of data was improved.

6.7.3 SAMPLING TECHNIQUES

Having identified the data collection techniques, the next step was to choose the subjects from whom the data would be collected. Social researchers are frequently faced with the fact that they cannot collect data from everyone who is in the category being researched. As a result, they rely on getting evidence from a portion of the whole, in the expectation and hope that what is found in that portion applies equally to the rest of the population. Veal (1997) defines a population as the total category of subjects, which is the focus of attention in a particular research project. The sample needs to be carefully selected if there is to be any confidence that the findings from the sample are similar to those found among the rest of the category under investigation. Two questions arise when selecting the sample:

1. What procedures must be followed to ensure that the sample is representative of the population?
2. How large should the sample be?

There are two kinds of sampling techniques that can be used by social researchers. The first is known as 'probability' sampling, the second as 'non-probability' sampling.

6.7.3.1 Probability Sample

In a probability sample, every subject in the sampling frame has an equal chance of being included in the sample. In other words, a probability sample is a technique, which ensures a random sample; which by implication is likely to be free of potential bias. Furthermore, a probability sample allows the precision of the results to be quantified and the level of confidence associated with them to be stated. However, the availability of an accurate sampling frame is a prerequisite for this type of sampling. Where a sampling frame does not exist, this kind of sampling is not usually possible and non-probability sampling is used. There are several types of probability sampling:

Random sampling this approach to sampling involves the selection of people or events literally 'at random'.

Systematic sampling is a variant of random sampling. It operates on the same principles but introduces some system into the selection of people or events.

Stratified sample can be defined as one in which every member of the population has an equal chance of being selected in relation to their proportion within the total population. Stratified sampling continues to adhere to the underlying principle of randomness. However, it adds some boundaries to the process of selection and applies the principle of randomness within these boundaries. It is something of a mixture of random selection and selecting on the basis of specific identity or purpose.

Multistage sampling designs are increasingly being used as sampling experts become more sophisticated. Usually these designs combine various types of sampling methods in order to take advantage of the positive features of each. So, multistage cluster sampling involves a number of stages. As the name suggests, it involves selecting samples from samples, each sample being drawn from within the previously selected sample.

6.7.3.2 Non-Probability Sampling

There are several different types of non-probability sampling but all have one thing in common - not all elements have an equal chance of being selected. Such samples are not random and the degree of sampling error cannot be determined.

The two kinds of sampling technique (probability and non-probability) are utilised in this research. A survey of major stakeholders was seen as appropriate to identify differences between the needs, desires, and perceptions of each stakeholder groups. These differences may be fundamental to identifying the differences of opinions, attitudes, values and beliefs between stakeholder groups.

Thus, the first step in sampling was to define the stakeholder groups. A stakeholder for this study is considered to be any group that is affected by or affects the decision of Egypt joining the WTO and the GATS in relation to the tourism industry. The research investigated three stakeholder groups, which have been identified in earlier chapters as the major influences of the Egypt tourism development, moreover these groups represent Egypt in the GATS. The three main groups are:

1. Institutional organisation;
2. Tourism private enterprises; and
3. Tourism experts (see figure 6.6).

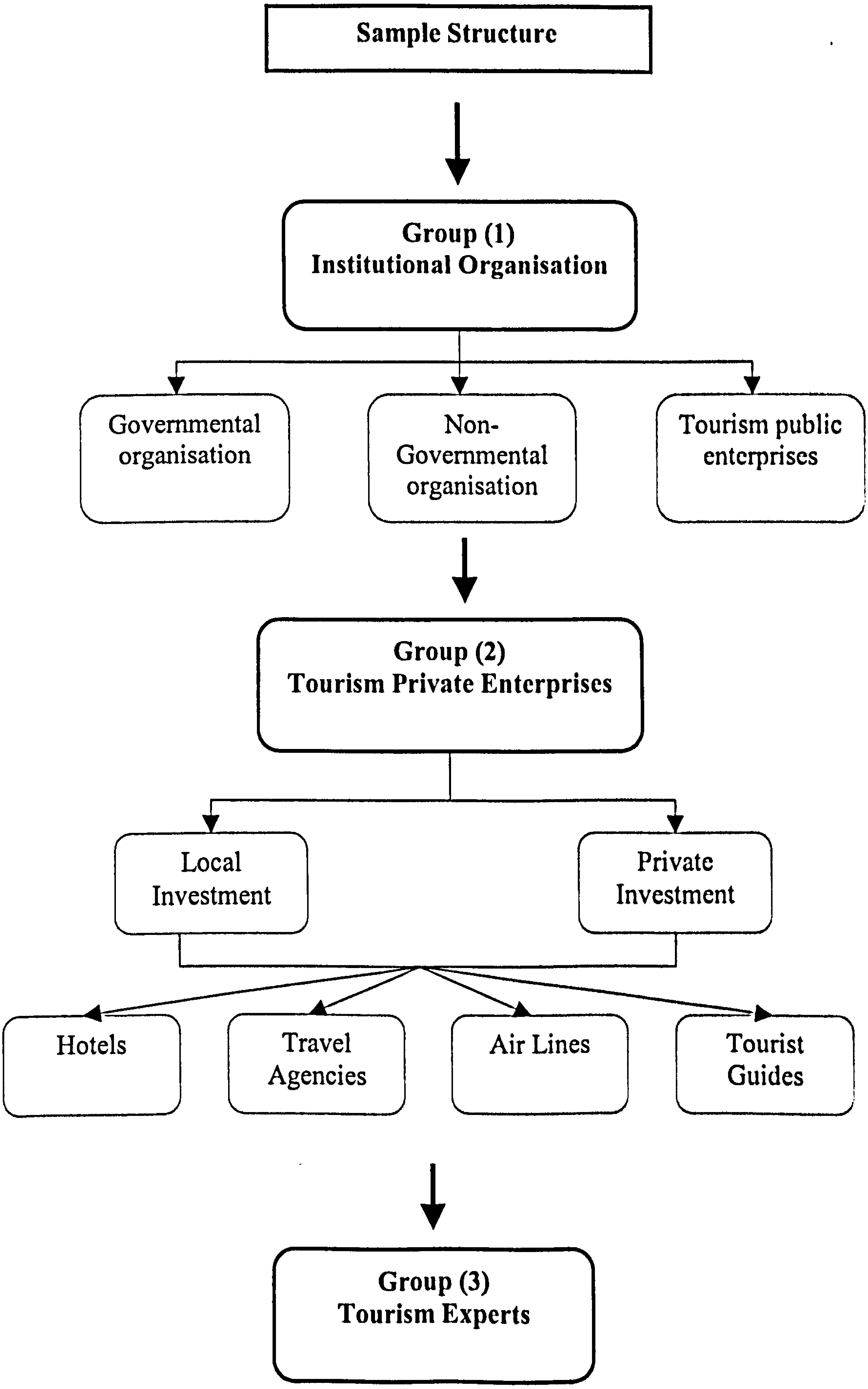


Figure 6.6: Sample Structure

1. Institutional Organisation

This group was selected because it represents the views of those who develop policy and planning, co-ordinate activities, and make decisions for future development and public good. For the purpose of this survey, the institutional organisations include:

- Tourism Ministry;
- Economic Ministry;
- Public Affair Ministry;
- Foreign affair Ministry;
- Non-governmental organisation;
- Public tourism enterprises.

2. Tourism Private Enterprises Group

This group was selected because it is directly dependent on the tourism industry. Moreover, this group is highly affected by GATS, which could affect the tourism development in Egypt. The tourism sector was represented by a broad cross-section of tourism business:

- Hotels and restaurant;
- Tour operator and travel agencies;
- Airlines;
- Guide services.

3. Tourism Experts Group

Many of the tourism experts are directly or indirectly involved in tourism policy, planning and decisions. For the purpose of this research, the researcher saw that their views and perceptions would help to achieve the research objectives.

6.7.4 SELECTION OF SUBJECTS

In respect of sample size, the focus of this survey was not to have a very large sample but to determine the sample size by the number of sub-groups (independent variables). Due to of differences among the three groups (government, tourism private enterprises, tourism experts), different sampling methods were used to obtain a representative sample from each group.

6.7.4.1 Institutional Organisation Sampling

The researcher identified three main sub-groups to be investigated: governmental organisation, non-governmental organisations and public enterprises. Non-probability sampling was used for the selection of this group. The sampling procedure used was judgmental and purposive sampling, whereby representatives of the sample are identified in accordance with the interest of the research because they are more likely to be involved in the tourism industry or GATS process.

44 government and non-government officials were selected from four ministries: Ministry of Tourism, Ministry of Economics and Foreign Trade, Ministry of Public Affairs and Ministry of Foreign Affairs. The researcher selected those with an involvement in tourism development in Egypt and international economic relations.

6.7.4.2 Tourism Private Enterprises Sampling

A sample frame of the supply sector was selected through a four-stage sampling method. Using a multistage stratified sample. 140 enterprises were investigated.

Stage 1: The main objective of this stage is to identify the tourism supply sector in Egypt, which would affect or be affected by GATS. Four sub-sectors were identified:

- Hotels and restaurant;
- Tour operators and travel agencies;
- Airlines;
- Guide services.

These sub-sectors were selected because they cover most tourism activities in Egypt. 140 enterprises took part in the research; an attempt to interview 10% of each sub-sector was made. Table 6.2 indicates the estimated population, sample frame and the response rates for each sector. Regarding airline and tourist guides, no information was available for stratification. Therefore, systematic sampling was used to select 10 tourist guides and 10 airlines from each sector. The response rate for the private enterprises was very high (82%).

Table 6.2: Population, Sample Frame and Response Rate

Sector	Estimated population	Sample frame	Response rate	
		No.	No.	%
Hotels	563	55	48	87.2
T.A	959	95	76	80%
Airlines	-	10	8	80.0
Tourist guides	-	10	8	80.0
Total	-	170	140	82.3

Stage 2: At this stage the main objective was to identify the subject according to the category. In other words, the criteria used in this stage is the category of the sub-sectors. With respect to the hotel sub-sector, 5, 4 and 3 star hotels were approached. 2 and one star hotels were excluded from the research because they are mostly small privately owned hotels and thus, much of the information required for the research would not be available and they are less likely to affect or to be affected by GATS. 5, 4 and 3 star hotels were mostly appropriate to achieve the research objectives.

Given that the top executives of 5, 4 and 3 star hotels were used to dealing with issues related to their different mix of business, and in many cases, international operations, which bring cultural differences and exposition to a whole range of different issues, much more information could be gained and the quality of the information could be guarantied. Moreover, most of the hotel groups, especially 5 and 4 star hotels, have shares in stock markets in many places in the world, which again gives them another dimension.

In order to achieve a representative group within the hotel group, the researcher started to choose the hotels randomly in a selected hotel categories (5,4 and 3 star hotels) to choose the hotels from the hotel list obtained. Table 6.5 indicates the estimated population, sample frame and the response rate achieved for each hotel category.

Table 6.3: Population, Sample Frame and Response Rate (Hotels)

Hotel category	Estimated population	Sample frame	Response rate	
		No.	No.	%
5 star hotel	218	20	20	100
4 star hotel	146	15	11	73.3
3 star hotel	199	20	17	85
Total	563	55	48	87.2

Travel agencies in Egypt are divided into three main categories; each with its own characteristics:

Category A: deals in general tourism (operation of tourism programme, transportation, booking, etc);

Category B: deals in ticketing reservations;

Category C: deals only in travel transportation.

The research investigated the three categories of travel agencies, because they all directly deal with tourism, and their services are an integral part of the schedule of specific commitments of Egypt in the GATS agreement. Thus the travel agencies group is quite representative of the range of tourism products in the market. Many of the travel agencies category A have large international operations, while others (category B and C) are mostly Egyptian. Table 6.5 indicates the estimated population, sample frame and the response rate.

Table 6.4: Population, Sample Frame and Response Rate (Travel Agencies)

T.A category	Population	Sample frame	Response rate	
		No.	No.	%
A	757	70	59	84.2
B	50	10	7	70
C	152	15	10	66.6
Total	959	95	76	80

For airlines, the criteria of the category is not applicable, but it is worth mentioning that the majority of private airlines in Egypt are mostly Egyptian and they operate their business exclusively within Egypt, because of the monopoly practice of Egypt Air. An attempt to represent the private airline and the branches of international airlines was made.

For guide services, the category criteria are not applicable.

Stage 3: After the groups were determined, the next step was to make a list of the samples. There were various sources for the sampling lists. For hotels, a main source for the sampling lists was the Hotel Directory of Egypt (2000), produced by the Hotel Chamber of Egypt. For travel agencies, the main source was Travel Agencies Directory (2000) produced by the Travel Agencies Chamber of Egypt. For airlines, the Air Transport Directory (2000) was used, produced by the Civil Aviation Association. The main source for guide services was the Guide Services Directory (2000) produced by Guide Services Association.

To enrich these lists, additional sources were used, including local, national directories, data published by the authority (e.g. tourism in figures, tourism Ministry) and the Internet. All these sources were the best possible for designing a comprehensive sampling list for each sector, which contained location of establishments, address, name of director, as well as category.

Stage four: The next step was to select enterprises from the lists. Stratified random sampling was used to select the subjects.

An attempt to interview one general manger, executive manger or owner/manger in each individual sub-sector was made. The decision to interview the top management was made in order to approach the decision-makers. Indeed, in most companies top decisions are a matter for head office. In addition, studies by Hambrick (1981) and Hambrick and Mason (1984) on the effects of top management characteristics on organisational outcome showed that job level can affect an executive's perceptions about his organisation as a whole. Finally, the higher an executive is in the organisation, the more likely she/he is to know about and have access to information.

6.7.4.3 Tourism Experts Sampling

The research identified three main groups with a different background to be investigated: tourism, economics and law. Non-probability sampling was used for the selection of this group. The sampling procedure used was judgmental and purposive sampling, whereby representatives of the sample are identified in accordance with the interest of the research because they will shed light on a particular aspect of the phenomenon under investigation (Hornby and Symon, 1994).

14 tourism experts were interviewed; the majority had direct involvement in the tourism development. Telephone contact with each targeted participant was made and an interview time and date were arranged with those who agreed to collaborate with the research.

6.7.5 PILOT STUDY

Pilot surveys are small-scale 'trial runs' of a larger survey. Pilot survey relates particularly to questionnaire surveys, but can in fact relate to trying out any type of research procedure. It is always advisable to carry out one or more pilot survey before embarking on the main data-collection exercise. The purposes of pilot surveys could be summarised as follows:

- Test questionnaire wording test question sequencing;
- Test questionnaire layout;
- Familiarity with respondents;
- Test fieldwork arrangements;
- Train and test fieldworkers;

- Estimate response rate;
- Estimate interview etc. time;
- Test analysis procedures.

Finn et al (2000) state that the aim of the pilot survey is to test reliability and validity of the survey. The reliability of the survey rests to some degree on the quality of the questionnaire. The validity of the survey instrument rests on whether it measures what it intended to measure. To some extent, this depends upon how well the subject was conceptualised. A crucial issue is whether the questions are understood consistently by all respondents; that is; that the question can be assumed to have a single meaning. This is often not that straightforward as different words/activities are interpreted differently in other cultures.

According to the objectives of this study, two stages of the pilot survey were carried out by the researcher. The first stage of the pilot study was carried out with the objective of validating the data collection techniques of the first stage of this research, which aims to examine the level of understanding of the WTO and GATS rules and principles and its implication for tourism industry, through a semi-structured questionnaire. The second stage of the pilot study was to validate the data collection techniques of the second stage of this research.

6.7.5.1 Pilot Study (First Stage)

A pilot study was carried out with the objective of validating the data collection techniques and to see whether the data to be collected would give the researcher the information needed to achieve the objectives of the research.

With respect to the objectives of the first stage (examine the level of understanding of the WTO and GATS rules and principles and its implication for tourism industry) the researcher developed a semi-structured questionnaire, mainly concerned with the WTO and GATS rules and principles such as: MFN, national treatment, market access and schedule of specific commitments. As discussed in chapter 4 and 5, GATS principles and rules are the most important elements of the agreement and are integral part of it.

The pilot was undertaken with ten subjects: 3 government staff, 5 industry staff and 2 tourism experts. The result of the pilot study revealed that all the questions were valid.

6.7.5.2 Pilot Study (Second Stage)

A number of questionnaires were piloted. The purposes of the pilot study in this stage were to:

- Test questionnaire wording;
- Test question sequencing;
- Test questionnaire layout;
- Familiarity with respondents;
- Estimate response rate; and
- Test analysis procedures.

10 pilot questionnaires were carried out: 3 government staff, 5 industry staff, and 2 tourism experts.

The results of the analysis of the pilot study revealed that apart from one question (question number 17 in questionnaires 1 and 2) which was rejected because it is not applicable, all the others were considered valid.

6.8 SECONDARY DATA ANALYSIS

Secondary data refers to the analysis of information collected for a purpose other than that of the researcher - in this sense the researcher becomes the secondary user of the data. In contrast, primary data is original data generated by new research using techniques such as surveys, interviews or observations. Most research will include an element of secondary data collection to discover what work has already been carried out on a particular subject. This is a necessary first step in any research design, and forms an important part of the literature review stage.

However, the word analysis in the title of this section is the key one. When carrying out this type of research, information is not just collected and reproduced in similar or identical form, instead, the data is re-worked to address the research objectives. Hakim (1982) defines secondary data analysis as "any further analysis of an existing data set which presents interpretations, conclusions, or knowledge additional to, or different from, those presented in the first report on the inquiry as a whole and its main results" (Hakim, 1982, p. 1). This method usually refers to the analysis of quantitative data (in particular government/official statistics) generated usually by surveys or a process of registration. The term secondary analysis can also applied to the associated with these sources of qualitative information is more usually referred to as content analysis. Therefore, at this stage it is important to appreciate that secondary data analysis can be carried out on both quantitative and qualitative data. Dale et al (1988) state that secondary analysis can provide a means by which the benefits of the survey, particularly its ability to provide a national level dimension, may be combined with other methods to bridge the traditional dichotomy of qualitative and quantitative analysis.

For the current research secondary data analysis is considered an integral part of the analysis. A combination of quantitative and qualitative methods for secondary data analysis were used in order to:

- Examine trends over time. For example, to examine visitor numbers and nationality to Egypt over the last ten years and compare those with other Middle East and North African countries (MENA region).
- Examine the economic performance of Egypt before and after the current economic reform.
- Examine the impacts of the new macro-economic policy on the investment in Egypt.
- Explore the relationship between the existing policy of privatisation and business environment in Egypt.
- Analyse Egypt's GATS schedule of commitments to explore how Egypt is similar to or different from WTO countries.

The actual techniques used in secondary data analysis are similar to those used in primary data analysis. The secondary data were collected from different sources:

- Official government statistics (e.g. Economic Ministry in Egypt, tourism in figures, etc);
- International organisations (e.g. WTO, World Bank, UNCTAD, IMF, WTTC, etc);
- Economic Reports about Egypt;
- Previous research.

6.9 DATA ANALYSIS

Having collected the data the next step is to analyse it. The data was carefully inputted into the SPSS (Statistical Package for the Social Science) version 10.0. An accuracy check was carried out both at the time of the input as well as after all data was inputted; some corrections were made.

According to Finn et al (2000), before applying any statistical methods, it is vital to appreciate the different types of variables that exist because this determines the form of analysis that can be undertaken. Most writers on statistics refer to three types of variable - nominal, ordinal and interval/ratio variables. These are often referred to as the three levels of measurement.

Nominal Variables: these involve categories that imply no specific order such as gender (male/female), and so some books refer to nominal level variables as "categorical" variables. Such variables must be mutually exclusive; in other words, it should not be possible for a case to fall into more than one category. In terms of analysis, frequencies are the most appropriate measurement for the categorical variables. For this reason, nominal level variables are said to contain the least information.

Ordinal Variables: these rank the items in order but it is impossible to quantify precisely how much difference there is between the categories. On other words, ordinal variables measure the intensity or degree of something by ordering categories (e.g. Likert scale). Therefore, ordinal variables are thus used to rank things. However it can not be assumed the distance between ranks is the same. They clearly contain more information than nominal variables.

Interval/Ratio Variables: these rank the item in numerical order and identify the differences between the variables (e.g. age). Interval /ratio variables contain the most information, as a result, more statistical tests can be applied than on the other two types of variables.

As figure 6.7 Shows, the statistical techniques used in this research are as follows:

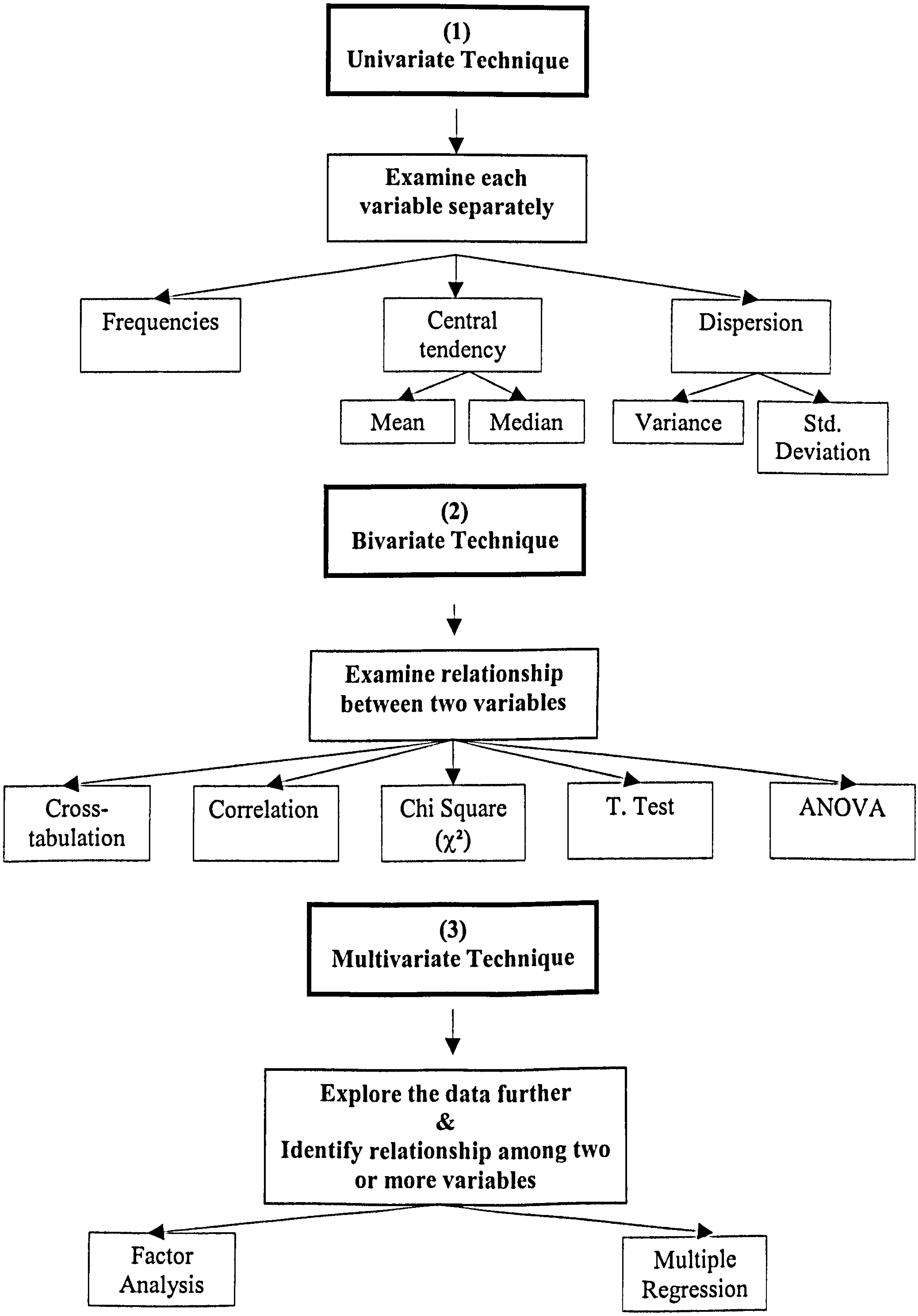


Figure 6.7: Data Analysis Statistical Technique

6.9.1 SINGLE VARIABLE ANALYSIS (UNIVARIATE TECHNIQUES)

The first step in analysing the data is to summarise the data in order to make the research findings more easily understood. This is done by examining each variable separately. Two approaches are considered in this stage - the use of descriptive statistics and the use of tables and graphs.

One of the important ways used in summarising the data at this stage is the frequency analysis. The frequency distribution of a variable is used to identify the number of cases in each category. Frequency simply means the number of times that something occurs (Black, 1999). In addition to the frequency analysis, the researcher used the central tendency analysis (average) to summarise the data.

In addition to being interested in the typical or representative score for a distribution of values, the researcher interested in the amount of variation shown by that distribution "how much dispersion or spread there in the distribution of values in a sample". The research used the variance and standard deviation "the square root of the variance" to measure the dispersion in the distribution.

Univariate techniques revealed an interesting pattern of response. However, the analysis of a single variable is unlikely to explain the patterns and the research interested in the connection between that variable and each of a number of other variables. Therefore, Bivariate techniques were utilised.

6.9.2 BIVARIATE TECHNIQUES

The univariate techniques are used for answering descriptive questions; such as how many, what is average and so on. These questions are univariate in nature; that is in order to answer them they only require information on a single variable. The present research poses questions, which are more complex than this. For example, are there any differences between the perceptions of government and private enterprise groups of tourism liberalisation? In order to answer this question the researcher needs to examine two variables simultaneously- group activity and level of perception. The question would require bivariate analysis.

Bivirate analyses examine the connections among variables. It takes two forms: relationships and differences. The researcher was interested in examining the two forms of connections (relationship and differences).

The first step in the bivariate analysis focused on relationships between pairs of variables. The investigation of relationships is an important step in explanation and consequently contributes to the building of theories about the nature of the phenomena in which the research interested (Bryman and Cramer, 1999).

Cross-tabulation is one of the simplest and most frequently used ways of demonstrating the presence or absence of a relationship. This simple technique is an extension of the principles of tabulation and the percentaging of data covered in the univariate analysis (frequency analyses). Cross-tabulation is simply a method of displaying data so associations can be readily observed and measured. The purpose of cross-tabulation is the investigation of association, to see whether or not an association exists between the independent and the dependent variables (Black, 1999).

Pearson's (r) and Spearman's correlation coefficient (P) were used to assess not only the strength of the relationship but also the direction between two ordinal variables. The correlation coefficient is an informative measure, which tells us how strongly two variables are related. The higher the correlation, the more likely the independent variable is to impact significantly on the dependent. In other words, the strength of the correlation lends weight to the assumption that two variables are causally linked (Foster, 2001).

To determine whether the differences between the distributions of two variables are statistically significant, a number of statistical methods were used. The central purpose is to ascertain whether the difference between two groups is small enough to have occurred by chance or large enough to apply to the whole population. If the difference is large then we can argue that the independent variable has an affect on the dependent variable.

The most widely known test for comparing frequency distributions of two variables is the Chi square (X^2). The T.test was also applied to compare the variability of responses based on means calculated for one dependent variable and one independent variable divided into two sub-groups. The T.test is applied for those instances where there are only two groups in the data. When the independent variables was divided into three or more sub-groups, One Way Analysis of Variance (ANOVA) was applied. ANOVA is a parametric test, which requires that the dependent variable is at an interval/ratio level of measurement and that the independent variable is categorical (Bryman and Cramer, 1999). In this sense it is similar to t.test. It is worth mentioning that, statistically insignificant results are just as important and noteworthy as statistically significant ones.

6.9.3 MULTIVARIATE TECHNIQUE

In an attempt to explore the data further and identify any relationships among three or more variables simultaneously, it was decided to analyse the data using more complex analytic techniques namely multivariate statistics.

Multivariate analyses were used to measure the perceptions of community group towards tourism liberalisation and the impacts of GATS on tourism development. To do that, the questionnaire was divided into three sections:

1. section one: tourism liberalisation;
2. section two: GATS and tourism;
3. Section three: the impacts of GATS.

Each section was analysed separately. This helped the researcher to identify the major factors affecting each phenomenon. Then a comparison study was carried out with a particular aim to measure the impacts of GATS on tourism development in Egypt (see figure 6.8).

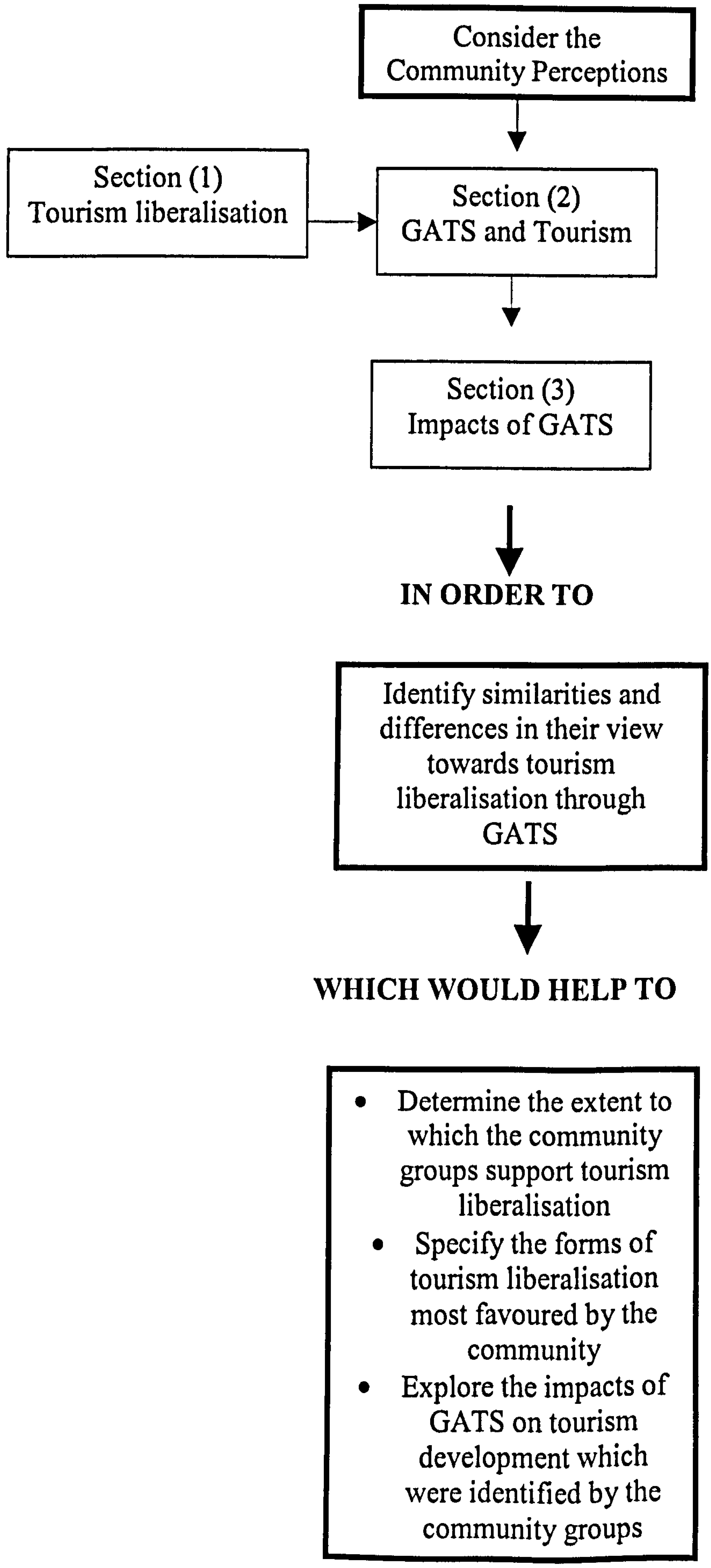


Figure 6.8: Perceptions of the Tourism Liberalisation and GATS

Appropriate statistical methods were applied to explore the results. Two multivariate methods were used: factor analysis and multiple regression.

6.9.3.1 Factor Analysis

To examine the relationships between the variables, further analysis of community perceptions of tourism liberalisation and GATS was undertaken using exploratory factor analysis. Factor analysis is a technique or more accurately a family of techniques, which aim to simplify complex sets of data by analysing the correlation between them (Foster, 2001, and Bryan and Cramer, 1999). Therefore, the objective of factor analysis is to present a set of variables in terms of a smaller number of hypothetical variables.

Factor analysis techniques are used for three main purposes. First, they can assess the degree to which variables are tapping the same concept. If people respond in similar ways to questions concerning, for example, tourism liberalisation policy as they do to those about policy changes in Egypt, this implies that these two concepts are not seen as being conceptually distinct by these people. If, however, their answers are unrelated to each other, this suggests that these two concepts can be distinguished. In other words, factor analysis enables to assess the factorial validity of the questions, which make up the scales by telling us the extent to which they seem to be measuring the same concepts or variables (Lewis-Beck, 1994).

Second, if there are a large number of variables, factor analysis can determine the degree to which they can be reduced to a smaller set. The third use of factor analysis is related to the previous one but is more ambitious in the sense that it is aimed at trying to make sense of the bewildering complexity of social behaviour by reducing it to a more limited number of factors (Bryman and Cramer, 1999).

Two uses of factor analysis can be distinguished. The one most commonly used is the exploratory factor analysis in which the relationships between various variables are examined without determining the extent to which the results fit a particular model.

Confirmatory factor analysis, on the other hand, compares solution found against a hypothetical one. In this research, the exploratory kind was utilised, which is employed to identify the main constructs, which will explain the intercorrelation matrix between variables with as few factors as possible.

There are a number of considerations to bear in mind before carrying out factor analysis (Child, 1990; Hair et al, 1987; and Foster, 2001):

1. The outcome depends on the variables, which have been measured, and the respondents who yielded the data.

2. The number of respondents should not be less than 100; and there should be at least twice as many respondents as variables. Both the number of respondents and the ratio of respondents to variables should be as large as possible.

3. The respondents should be heterogeneous on the abilities or measures being studied.

As factor analysis is an interdependence technique it allows all of the variables to be considered simultaneously. Thus each of the (original) variables is considered as a dependent variable that is a function of some underlying, latent, and hypothetical set of factors (dimensions).

The fact that factor analyses is an interdependence technique is relevant to this study since all of the variables are equally important and reflect the phenomenon under investigation (tourism liberalisation through GATS).

6.9.3.1.1 Sample Size

Sample size is of key importance in the application of factor analysis. The reliability of the factors emerging from a factor analysis depends on the size of the sample, although there is no consensus on what the size should be. However, there is agreement that there should be more participants than variables. Gorsuch (1983), for example, has proposed an absolute minimum of five participants per variable and not less than 100 individuals per analysis. However, it is essential that the sample should be sufficiently large to enable the reliability of the analysis.

6.9.3.1.2 Calculation of a Correlation Matrix

The initial step to carry out factor analysis is to compute a correlation matrix for the variables, which helps to identify the scope and scale of the investigation (e.g. perceptions of tourism liberalisation and GATS). If there is no significant correlation between these items (variables) then this means that they are unrelated and we do not expect them to form one or more of the significant factors. In other words, it would not be worthwhile to go on to conduct a factor analysis. Consequently, this should be the first stage in deciding whether to carry one out.

Factor analysis offers two applications in calculating the correlation matrix: it can examine the correlations between the variables or the correlations between the respondents. In this study, factor analysis was used to examine the correlations between variables. Hair et al (1987) argue that this is the most common type of factor analysis. To group individual respondents, cluster analysis was found to be more appropriate. Black (1999) argues that cluster analysis is more common to group individual respondents.

6.9.3.1.3 Extraction/Factor Model (Principal Component or Factors Analysis)

The two most widely used forms of factor analysis are principal components and common factor analysis (called principle-axis factoring in SPSS). There are also other kinds of methods such as alpha, image, and maximum likelihood factoring, but these are used much less frequently (Lewis-Beck, 1994). The component model is used when the objective is to summarise most of the original information (variance) in a minimum number of factors for prediction purposes. In contrast, common factor analysis is used primarily to identify underlying factors or dimensions not easily recognised. The selection of the appropriate model requires an understanding of the types of variance.

Child (1990) argues that Factor analysis is primarily concerned with the describing the variance. The total variance for the purpose of factor analysis consists of three kinds of variance: common, specific (unique), and error.

Total variance = Common variance + Unique variance + Error variance.

Common variance is the variance, which is shared by the scores of people on three or more variable. Unique variance describe the variation which is specific or unique to a variable and which is not shared with any other variable. Error variance is that due to unreliability in the data-gathering process or a random component in the measured phenomenon. Since factor analysis cannot distinguish specific from error variance, they are combined to form unique variance. In other words, the total variance of a test consists of its common and its unique variance.

Total variance = Common variance + Unique variance.

The difference between principle-components analysis and principle-axis factoring lies essentially in how they handle unique variance. In principle-components analysis, all the variance of a score or variable is analysed, including its unique variance. In other words, it is assumed that the test used to assess the variable is perfectly reliable and without error.

In principle-axis factoring, only the variance, which is common to or shared by the tests, is analysed - that is an attempt is made to exclude unique variance from the analysis.

The primary objective of the research is to identify the latent dimensions on constructs represented in the original variables, and that the researcher has little knowledge about the amount of unique or error variance and therefore wishes to eliminate this variance. The appropriate factor extraction model for the present research is the principle axis factoring, which used primarily to identify factors or dimensions not easily recognised.

6.9.3.1.4 Number of Factors to be Retained

Since the objective of factor analysis is to reduce the number of variables, the next step is to decide how many factors we should keep. This is a question of how many of the smaller factors we should retain. There are two main criteria used for deciding which factors to exclude. The first is known as *Kaiser's criterion*, which selects those factors, which have an eigenvalue of greater than one. Since the total variance that any one variable can have has been standardised as one, what this means, in effect, is that a factor which explains less variance than a single variable is excluded.

Kim (1987a, p.247) defines Eigenvalue as "a mathematical property of a matrix; used in relation to the decomposition of a covariance matrix, both as a criterion of determining the number of factors to be extracted and a measure of variance accounted for by a given dimensions". That is, eigenvalue represents the amount of variance accounted for by a factor.

The rationale for the eigenvalue criterion is that any individual factor should account for at least the variance of a single variable if it is to be retained for interpretation. The eigenvalue approach is probably most reliable when the number of variables is between 20 and 50 (in the case of the present research, 27 variables for the first questionnaire, 32 for the second and 35 for the third questionnaire).

The second method is the graphical *scree test* proposed by Cattell (1966). In this method, a graph is drawn of the descending variance accounted for by the factors initially extracted. The term 'scree', in fact, is a geographical one for describing the debris found at the bottom of a rocky slope and implies that these factors are not very important. The factors to be retained are those that lie before the point at which the eigenvalues seem to level off.

6.9.3.1.5 Rotation of Factors (Orthogonal)

The rotation of factors is an important concept in factor analysis since one of the goals of factor analysis is to identify factors that are substantively meaningful (in the sense that they summarise sets of closely related variables).

According to Norusis (1993) and Kim (1987b), the rotation phase of factor analysis attempts to transform the initial matrix into one that is easier to interpret. Rotation of factors also improves the interpretation by reducing some of the ambiguities that often accompany initial unrotated factor solutions. The ultimate effect of rotating the factor matrix is to redistribute the variance from earlier factors to later ones to achieve a simpler, theoretically more meaningful factor pattern.

The techniques for extracting the factors generally endeavour to take as much common variance as possible in the first factor. Subsequent factors are, in turn, intended to account for the maximum amount of the remaining variance until no common variance remains (Child, 1990).

The first factors extracted from an analysis are those which account for the maximum amount of variance. A number of ways have been developed to rotate factors. The two most commonly used methods are orthogonal rotation and oblique rotation. Orthogonal produces factors which are unrelated to or independent of one another. Therefore, the correlation between factors is arbitrarily determined to be zero (Hair et al, 1987). Oblique rotation, in which the factor are correlated. To date, non-of the oblique solutions have been demonstrated to be analytically superior.

The objective of the research is to reduce the number of original variables to a smaller and more significant set of dimensions (factors), and that the oblique solution is still a subject of controversy and experiment, the orthogonal solution has been chosen.

6.9.3.1.6 Orthogonal Rotation Methods

There are mainly three Orthogonal rotation approaches: Quartimax, Varimax, and Equimax. The most commonly used method is the varimax method, which attempts to minimise the number of variables that have high loading on a factor and therefore, the interpretability of factors is easier.

The varimax method has proved very successful as an analytic approach to obtaining an orthogonal rotation of factors. Therefore, orthogonal solution and varimax rotation have been chosen for the present research.

6.9.3.1.7 Interpretation of Factors

A factor is a group of variables that have some characteristic in common. In order to find out if a group of variables have something in common it is necessary to know that the correlation between each pair of variables. This is done by employing the technique of correlation. As discussed in previous sections, when a factor contains two or more variables with significant loading, it is referred to as a common factor and the variance of the variables in that factor is known as common variance. The primary aim of factor analysis is the discovery of these common factors.

It has also observed before that common factors accounted for the intercorrelations between variables, and therefore, there is bound to be at least two variables involved. The factors in this research are observations of tourism liberalisation and GATS in Egypt.

The interpretation and labelling of factors is not a simple matter. It depends entirely on the discretion and understanding of the researcher. The process of giving meaning to the extracted factors involves substantive interpretation of the pattern of factor loading for the variables in an effort to name each of the factors. Variables with higher loading influence to a greater extent the name or the label selected to represent a factor.

6.9.3.2 Multiple Regression Analysis

Multiple regression is the most widely used method for consucting multivariate analysis, particularly when more than three variables are involved (as the case of the present research). It is closely connected to Pearson's correlation (*r*). It shares many of the same assumptions as (*r*), such as that relationship between variables are linear and that variables are interval. Multiple regression examines the relationship between dependent variables and two or more independent variables. The aim of regression analysis is to predict the dependent variable by knowing several independent variables. However, in this study multiple regression was utilised to identify the number of independent variables, which are more strongly related to the dependent variables (factor), and to estimate the percentage of variance in each factor explained by the independent variables (Bryman and Cramer, 1999).

The nature of the relationship between the dependent variable and the two independent variables is expressed in a similar manner to the bivariate case. The analogous equation for multivariate analysis is:

$$Y = a + b_1x_1 + b_2x_2 + e$$

Where x^1 and x^2 are the two independent variables, a is the intercept, b^1 and b^2 are the regression coefficients for the two independent variables, and e is an error term which points to the fact that a proportion of the variance in the dependent variable, y is unexplained by the regression equation. The regression coefficient expresses the amount of change in the dependent variable with the effect of all other independent variables in the equation partialled out. The strength of multiple regression lies primarily in its use as a means of establishing the relative importance of independent variables to the dependent variable.

There are three forms of multiple regression: forward, backward and stepwise. Stepwise regression was used because it is the safest method when the aim is to explore the data for a solution, which accounts for the maximum variance for a minimum of independent variables. In stepwise regression the variables are placed in the model, one at a time. If any variable does not contribute significantly to the model, it is removed.

6.10 LIMITATIONS AND ISSUES OF RELIABILITY AND VALIDITY

From a methodological point of view research is assessed using terms like 'reliability' and 'validity'.

Reliability is about consistency of the results obtained from a measuring instrument in pieces of research. If the measuring instrument is a questionnaire, then the questions included should obtain the same answer from a person each time it is asked.

It can be seen that the model is taken from the natural sciences where, if experimental conditions are properly controlled, a repetition of an experiment should produce identical results. This is rarely the case in the social sciences. This means that the social scientist, including the leisure and tourism researcher, must be very cautious when making general statements on a degree of generalisability.

A reliable question will be a simple, clearly worded question that will yield the same results on different occasions. Earlier the research discussed the problems of operationlising concepts into variables. To enhance reliability, each variable representing the concept should be as specific as possible.

Validity is the extent to which the information collected by the researcher truly reflects the phenomenon being studied. Leisure and tourism research is fraught with difficulties in this area, mainly because empirical research is largely concerned with people's behaviour and with their attitudes.

Finn et al (2000) point out that validity is whether the measuring instrument measures what it is supposed to measure. The instruments are subjects to a number of imperfections. Questionnaires for example, are designed to gather information from individuals about their characteristics, behaviour and attitudes. Whether or not they actually achieve this depends on a number of considerations. The interview situation is not always conductive to careful, thoughtful responses. Respondents may tend to exaggerate or understate in their answers to some questions. They may also have problems in recalling some information accurately. Respondents may tend to give answers, which they believe will please the interviewer. Thus the validity of questionnaire-based data - the extent to which they accurately reflect what they are meant to reflect - is a constant source of concern.

However, there are some measures, which were taken by the researcher to ensure the validity of the questionnaire as much as possible and also to check on the presence of any of the problems discussed above. One approach is to include two or more questions in different parts of the questionnaire, which essentially ask the same thing. The researcher also made sure that all the questions are easy to understand.

There are various components to the idea of validity (Finn et al, 2001). A distinction can be made between internal validity and external validity. Internal validity refers to whether the hypothesised cause produces the given effect in the piece of research.

External validity refers to the extent to which the results of the research can be generalised. This is also referred to as the representativeness of the research's results. Finn et al (2000) identify two aspects of external validity, population and ecological. Population validity is about whether the research can be generalised to other groups of people outside the sample researched. Ecological validity is about generalisation to other settings.

In the discussion of reliability, the researcher referred to deriving variables from concepts, and how these variables should be reliable, in addition, these variables, or indicators of the concepts, should also be valid. This is referred to as measurement validity. It is quite possible for a concept to be operationalised into a variable that is reliable but not valid i.e. a good measure of the concept. According to Finn et al (2001), there are ways of improving the validity of the operationalised concepts. They include:

- Approaching people who are employed in leisure and tourism industries for their professional advice;
- Consulting with previous published research;
- Using more than one method of data collection to triangulate the results;

- Sound understanding of the theory underpinning the research.

6.11 SUMMARY

This chapter has introduced the research process that was followed in order to complete this research. According to Finn et al (2000), research is not that simple. There are important key decisions that have to be taken before the research process is set in motion. The entire research process used in this survey has been analysed from beginning to end, in order to understand each step followed.

As outlined in this chapter, this research started with the discussion of the theory of comparative advantage and its implication for tourism industry. This research followed the general outline of survey research design, with special attention and focus on tourism liberalisation through GATS in Egypt. Therefore, sampling, questionnaire design and distribution methods and possible analysis techniques were evaluated and revised many times before conducting the fieldwork.

CHAPTER SEVEN

EGYPT: INTRODUCTION TO CASE STUDY AREA

7.1 INTRODUCTION

Egypt has come a long way in a short time. 10 years ago, the country was suffering enormous economic problems. Its foreign debt was far greater than its GDP, growth was stagnant, and the economy was dominated by an inefficient public sector. The rise of Islamic trend was threatening the stability of the country.

All these factors have improved radically. Egypt's economic stabilisation programme, initiated in 1990/91, has produced significant results in most macroeconomic areas. Growth has held steady at over 5% per annum; debt has declined to an easily manageable size, and much of private industry has grown rapidly. The country's capital markets have been dynamised, and flows of foreign direct investment are substantial and growing. Egypt has also joined various free trade agreements and moved towards liberalisation of its economic activities. Moreover, the country joined the World Trade Organisation (WTO) and signed all its agreements in 1995. This chapter discusses the economic structure of Egypt and the recent economic developments.

7.2 LAND AND PEOPLE

7.2.1 LOCATION

Egypt lies between latitudes 22°; and 32°; north of the equator and between longitudes 24°ý and 37ý°ý; east of the Greenwich line. It occupies the North-Eastern corner of the African continent. It comprises some 3% of the total area of Africa. It is bounded as follows:

- To the North, by the Mediterranean Sea with a 955km-long coast;
- To the South, by 1280km-long border with the Republic of Sudan;
- To the West, by 1115 km-long borders with Libya;
- To the East, by the Gulf of Aqaba and the Red Sea with a 1941 km-long coast;
- To the Northeast, by 265 km-long borders with Palestine and Israel.

The roughly rectangular area that is Egypt, with the little appendage of Sinai, covers more than one million square kilometres (1,002,000 km^2) of which 55367 km^2 (5.5%) are populated. Its length from north to south is about 1073km; and its width exceeds its length by about 189 km; yet of this total no more than 3 to 4 % is arable land. Cultivation is restricted to the entrenched and fertile Nile Valley, and to the lush Delta occupying the triangle between Cairo and the sea (Yearbook, Egypt, 1999).

Cairo, the capital of the Arab Republic of Egypt, is the largest city in the Arab world and Africa in order of population. In 1999, the population was estimated at 6.933 million. Egypt is divided into four major parts:

1. Nile Valley and Delta:

It has an area of about 33000 km^2 (less than 4% of the total area of the country), while the remaining area is desert. It extends in the south from the north of Wadi Halfa up to the Mediterranean coast in the north. It is divided into:

- Upper Egypt, extending from Wadi Halfa to the south of Cairo;
- Lower Egypt (Nile Delta), extending from the north of Cairo to the Mediterranean;
- The River Nile, extending over 1532 km from Egypt's southern borders through two estuaries up to the Mediterranean.

2. Western Desert:

The Western Desert occupies an area of about 680,000 km^2 (68% of Egypt's total area) extending from the Nile Valley in the east to the Libyan borders in the west, and from the Mediterranean in the north to Egypt's southern borders. It is divided into two sections:

- The northern section, including the coastal plane, the northern plateau and the Great Depressions area, including Siwa Oasis, Qattara Depression, Notroun Valley and Baharia Oasis;
- The southern section, inlcuding Farafra, Kharga and Dakhla Oasis and al-Owainat to the extreme south.

3. Eastern Desert:

Its area is about 225,000 km^2 (28% of Egypt's total area). The Eastern Desert is marked with the eastern mountain range along the Red Sea with peaks that rise up to about 3000 feet above sea level.

4. Sinai Peninsula:

With an area of about 6100 km^2 (6.1% of Egypt's total area), Sinai is shaped like a triangle, its base rests in the north and its apex in the south. It is bounded by the Mediterranean to the north, the Gulf of Aqaba to the east and the Gulf of Suez and Suez Canal to the west. In terms of terrain, Sinai is divided into three main sections:

- The southern section, involving extremely rough terrain, is composed of high-rise granite mountains. Here Mount Catherine rises about 264 metres above sea level, thus making it the highest mountaintop in Egypt.
- The central section comprises the central plateau, known as at-Teah Plateau, where the valley slopes gradually towards the Mediterranean.
- The northern section comprises the area bounded by the Mediterranean to the west and at-Teeh Plateau to the south. It is a plane area, where abundant rainwater falls from southern heights and central plateau.

7.2.2 CLIMATE

Egypt lies within a dry tropical region, except for the northern parts that lie within a warm moderate region, with a semi Mediterranean climate characterised by hot dry summers and moderate winters with little rainfall, potentially heavier along coastal areas. The annual average temperature in Lower Egypt ranges from 20 centigrade during the day to 7 centigrade at night. In Upper Egypt, average temperature ranges from a maximum of 25 centigrade to a minimum of 17 centigrade.

7.2.3 POPULATION

Since the time of the Pharaohs, Egypt's inhabited area was confined to the narrow strip of the Nile Valley and Delta, accounting for no more than 4% of Egypt's land. As a result, population density in the Valley and Delta has been remarkably high. Pressure of population in the Nile Valley and its peripheries has recently grown so acute that available space could no longer accommodate the ever-growing population.

Population residing within the country, in 2000, was estimated at 64.6 million. Birth rates fell from 38.03 per thousand in 1986/87 to 27.50 per thousand in 1998/99. Mortality rates decreased from 9.2 per thousand in 1986/87 to 6.5 per thousand in 1998/99. Average population density is estimated at 1096 individuals per km^2 in inhabited regions. Population density can drop down to 61 individuals only per km^2, should the total area at the country be fully utilised. The population of the Cairo governorate, as of January 1, 1998, was estimated at 6.933 million, representing 11.4% of the country's population, with a density of 12780 per km^2, the highest in the country.

7.3 DOMESTIC POLITICAL AND SOCIAL ENVIRONMENT

In one of the world's most turbulent regions, Egypt stands out as a zone of relative tranquillity. Unlike any of its neighbours, the country has a history of relative political stability. The nature of the land, which concentrates the population in the narrow Nile Valley, has allowed for highly centralised forms of government, typically characterised by a strong leader and a powerful ruling establishment. Egypt's stability is also man-made. Having come to power through a military coup in 1952, the ruling establishment places a premium on maintaining security.

The legislature in Egypt is a bi-cameral branch split into the People's Assembly (PA) (Maglis Al Shaab) and the Advisory Council (Maglis Al Shura). The Advisory

Council is a consultative organ only and it is the Peoples Assembly that functions as the main representative law making body. The Assembly approves all government policies, laws, the state budget and the General Plan for Economic and Social Development.

The PA has a total of 454 seats of which 444 are filled by popular vote, and ten are presidential appointees. Elections and appointments take place every five years. The last parliamentary elections were in November 2000 (PA, 2001). Multi-party law was reinstated in 1977, and there are a variety of parties with a wide spectrum of political platforms. The ruling party, the National Democratic Party (NDP) is the largest party and the president of Egypt heads it. The NDP's broad ideology has given it greater flexibility to adapt to changing times both domestically and internationally. A positive development was recently seen with the creation of a new political party. This is the first time a party has received approval for establishment since 1977 (PA, 2000) (see table 7.1).

Table 7.1: Current People Assembly Structure (2000)

Party	Number of Seats
National Democratic Party	318 seats
Independents	112 seats
El Wafd Party	6 seats
Tagammu Party	5 seats
Nasserist Party	2 seats
Liberal Party	1 seat
Presidential appointees	10 seats

Source: People Assembly (PA) (2000)

In addition to the PA's legislative duties, it is charged with nominating a presidential candidate for national referendum. Under the 1971 constitution, a candidate is chosen by a two-thirds majority of the PA, and then confirmed by popular referendum. The president's term is six years from the date of announcing the results of the plebiscite; the incumbent may be re-elected for an unlimited number of successive terms. The president may appoint one or more vice-presidents and define their jurisdiction. At present, there are no vice-presidents.

The president of the Republic appoints the Cabinet, or the Council of Ministers, consisting of the Prime Minister, Ministers and their deputies. The responsibilities of the Cabinet include formulating and implementing the policies of the State; preparing draft laws and decrees; drafting the State budget; and preparing the General Plan for Economic and Social Development. Cabinet Ministers are not required to be members of the Assembly. The present Cabinet consists of 32 ministers; there are no deputies.

The Egyptian court is a four-tiered system. The judicial code combines elements from the Napoleonic Code, English Common Law and Islamic Law (Shari'a Law). The judicial system in Egypt has three components; the Supreme Constitutional Court, the Council of State, and the National Courts.

The Supreme Constitutional Court tops the four-tiered hierarchy that branches down into the court of appeals and primary and summary tribunals throughout the 26 governorates. It is also the highest judicial authority in Egypt.

The Council of State in the Ministry of Justice provides legal advice to the Government and its ministries and adjudicates administrative litigation in which the State is involved. The Council also reviews all draft legislation before it is considered by the Cabinet. Egypt has two kinds of national Courts; Regular Civil Courts, and Special Courts such as the Court of Ethics and State Security Courts.

All legislation, including amendments, must be introduced in, and passed by, the People's Assembly, by an absolute majority of members present. Each draft law is first referred to the Committee for Constitutional and legislative affairs in the Assembly, and, if appropriate, to other specialised committees, for recommendations. Once approved by the Assembly, the draft law sent to the President for approval. The President may withhold approval and refer back to the Assembly within thirty days. Draft laws nevertheless become law if they are approved by a two- thirds majority of the Assembly.

Egyptian law is based on the general subordination of domestic law to international legal instruments; under Article 151 of the constitution, any international agreement or convention, after being ratified by the Assembly and published in the National

Gazette, becomes legal in Egypt and cancels thereby all national legislation, notwithstanding constitutional provisions, that may contradict it. International agreements thus require no further legislative implementation to be invoked before national courts. However, in order to facilitate implementation, new legislation has been introduced to harmonise national laws with international commitments (PA, 2000).

7.4 ECONOMIC BACKGROUND

The 1952 Revolution was a key point in modern Egyptian economic history. In an effort to sever all ties with the colonial domination of the past, Gamal Abdel Nasser's government (1952-1970) adopted Socialist Oriented Policies aimed at "Egyptianising" the ownership of land and capital. Unfortunately, the urban upper class and wealthy former landlords did not co-operate and invest in the government's scheme, preferring instead to send their money abroad.

Consequently, the government chose to take the responsibility of industrial development upon itself. The typical inefficiencies of centrally planned state systems soon began to accumulate. Inward-focused policies allowed for the formation of protected monopolies with captive markets; thus quality and innovation suffered. As the government grew to dominate the economy, its role as the employer of last resort became muddled with its position as the primary employer, and enterprises became bloated and overstaffed.

Sadat's 1974 Open Door Policy marked a step towards liberalisation, encouraging private sector activity and seeking to lure foreign investment through revised laws, tax incentives and the creation of free zone. But the government's continuing domination of industry and the accumulated layers of bureaucratic regulation only left room for the blossoming of import trade. In addition to the government bureaucracy, the benefits from liberalised trade have been stymied by other domestic constraints including an inefficient service sector and overcrowded ports and transportation facilities (World Bank, 1998d).

Following the adoption of open-door policies economic growth in Egypt accelerated between 1975 and 1985. It was fuelled by sizeable increases in foreign assistance, remittances from Egyptian working abroad, and foreign direct investment. At the same time, the oil boom began to improve the economy, producing a glut of liquidity and supporting inefficient tendencies on the part of the government and consumers. Workers' remittances fuelled a growing trade deficit while official receipts financed further public sector expansion (BMI, 2000).

Following the drop in oil prices in 1982 and the concurrent rise in interest rates, Egypt's economic position became unmanageable. The budget deficit climbed to nearly a quarter of GDP, inflation soared into double digits, foreign exchange became scarce, and the government could no longer afford to service its external debt. Egypt's international credit increased, exacerbating the balance of payments crisis and real growth rates plummeted as the economy stagnated.

The level of aggregate demand in the economy then fell further in the early 1990s because of government spending cuts, and an increase in real interest rates, a drop in exports to the Former Soviet Union and Eastern Europe, and the drop of tourism income. Per capita growth of real national output slowed from an average of 2.5-3.0% a year in 1989-91 to 0.04% a year in 1993 (CBE, 2000a).

The Egyptian government responded with an impressive program of economic reform, which was adopted in 1991. The plan called for tighter fiscal and monetary polices a revision of the exchange rate and the privatisation of State companies. Foreign investors were quick to react. In 1995 they put 400 million dollars in foreign direct investment into Egypt, followed by 800 millions dollar in 1996 and around 1.2 billion dollar in 1997. Half the foreign direct investment is in manufacturing and 30% in banking. Tariff revenues as a share of total imports fell from 25% in 1985 to 17% in 1997, reflecting the country's increased openness to trade. As a result of these flows and trade reforms, real Gross Domestic Product GDP grew by 5.1% in 1996 and by 5.9% in 1997 (Ministry of Planning, Egypt, 2000).

The tide turned in 1997, however, following the drop in oil prices and the Luxor attack. These shocks undermined three of Egypt's most important sources of hard currency. Naturally the CBE (Central Bank of Egypt) had to begin releasing dollars to the market in order to keep the exchange rate stable. Simultaneously the government retired large quantities of Treasury-bills to unlock liquidity and pursued a slightly more expansionary fiscal policy in order to keep the economy from choking (CBE, 2000b).

7.5 ECONOMIC STRUCTURE

7.5.1 MOVING FROM A PLANNED TOWARDS A MARKET ECONOMY

Egypt's economy is small, yet relatively well diversified for what the World Bank categories as a 'lower middle income' country. Nominal GDP approaches 85 billion dollars, a level similar to Ireland or Chile, although Egypt must spread this wealth thinly across a population slightly larger than those in Britain or France. Nominal per capita GDP is around 1400 US dollar. Less than 20% of households have disposable incomes greater than 10.000 US dollar a year (CBE, 2000c).

Egypt is historically a prosperous country: in the 1920s, for instance, income per capita was two thirds that of Italy's. However, high population growth, wars and economic mismanagement have all contributed to relatively poor performance in the past 50 years. An experiment with centrally planned socialism in the 1960s proved to be disastrous. Capital and skilled manpower fled the country following massive nationalisations. Huge sums were expended on inappropriate heavy industry. Import substitution policies distorted the local market and rendered Egyptian products internationally uncompetitive, while heavy bureaucratic control stifled both entrepreneurial instincts and the climate of openness that sustains them (EFG-Hermes, 2000).

Beginning in the 1970s, various approaches were taken to remedy these ills, but it was not until the early 1990s that serious structural reform was attempted. The reforms' success – helped by a massive debt write-off by Western and Arab creditors as a reward for Egypt's key role in the 1991 Gulf War.

Egypt's economy is now far more *stable and attractive to investors.* Major achievements on the macro side include a sustained reduction of the budget deficit to around one-% of GDP, and of inflation to well below 5%. Additionally, the country's currency has remained solid, foreign reserves are equivalent to over a year's worth of imports, and the privatisation drive has seen the private sector's share of GDP rise from 60% to 70%. At the same time, wide-ranging administrative changes have liberalised and dynamised the economy (IMF, 2000).

According to the World Bank (1998), any discussion of Egypt's economic structure must be prefaced by recognition of the large informal economy. Estimates regarding the size of the informal sector range from 30-50% of total economic activity. The grey economy includes agricultural production, artisanal manufacturing, small-scale trade and personal services due to its marginal nature, however, it is virtually impossible to obtain reliable data on this activity.

According to CBE figures for 2000, the breakdown of public and private sector activity shows that the private sector is now responsible for 74% of all economic activity, up from 61% in 1992. However, this belies the continuing importance of government activity in the economy. Indeed a large part of the ostensible growth in the private sectors' share of economic activity is a matter of categorisation. When a company or public authority is partially privatised, its entire production is categorised as private sector. An example of this recognition may be found in the 1999 GDP figures. Until 1998, electricity was 100% public sector. In 1999, it suddenly became 92% private although the private activity in the sector is limited to three BOOT generation plans which came into development during the fiscal year. In addition, the majority of privatised companies do not necessarily function as private sector firms since the government often remains as the single largest shareholders in a fragmented ownership structure and as there is often no change in management or operations. EFG-Hermes 2000 estimates that a more realistic figure for bona-fide private sector activity would be closer to 63% of GDP.

Manufacturing accounts for 19% of economic activity in Egypt and employs 14% of the workforce. The non-petroleum industry has been one of the fastest growing economic sectors over the past five years with an average real growth rate of 8%. In fiscal 1999, the real growth rate jumped to 9.7%.

Food processing makes up the largest portion of industrial activity at 39% of non-petroleum industrial output. State controlled mills, edible oil companies, rice threshers, sugar refineries and tobacco manufacturing account for approximately one half of food processing. Higher value-added dairy, meat, produce and beverage processing is dominated by the private sector. In recent years, the private sector has also entered the traditional state domains of milling and edible oil, posing significant competition to state enterprises.

Engineering and electrical industries make up the best largest segment of manufacturing at 19% of non-petroleum industrial output. Egyptian industry produces consumer durables, consumer electronics, appliances, household wares, furniture and automobile components. Most automobiles sold locally are also assembled in Egypt due to extraordinary tariffs on imported vehicles. Aside from a few state enterprises in such basic industries as lights and batteries, this area of manufacturing is entirely dominated by the private sector.

The quality of premium Egyptian long-staple cotton is known worldwide. Unfortunately, Egypt's textile industry does not live up to the promise of its raw materials. Spinning and weaving account for 18% of non-petroleum industry, but years of state control have left the majority of players in the sector weak, overstaffed, inefficient and technologically out-of-date. There is of course, room for start-up private sector investment in textiles, and some ready-made clothing firms have experienced remarkable growth, particularly in high-end markets and export activities. But unfortunately, a complicated maze of economic policies and price distorting subsidies prevent local manufacturers from taking advantage of the prime raw material. Hence the only real comparative advantage for the local industry is abundant labour.

Building materials have been a mainstay of industrial growth over the past decade and currently account for 8% of non-petroleum industrial output. Cement, steel and ceramics have all seen robust growth as economic expansion has fuelled construction activity. This sector has also seen a rapid expansion of private sector involvement. A decade ago, the building materials sector was entirely state dominated, but through privatisation and private investment, the private sector share has risen to approximately 50% of total output.

Egypt's pharmaceutical sector has enjoyed steady growth in recent years despite tight government regulation and social pricing policies. It now accounts for 8% of non-petroleum industrial activity. Domestic production covers more than 90% of local demand and an additional 5% of total output is exported. Public sector companies have seen a rapid attrition in market share as private sector players and multinationals have grown to account for more than 76% of local pharmaceutical production. Egyptian companies manufacture generic drugs as well as products under license. The sector will undoubtedly witness significant changes, however, with the full application of the TRIPS agreement. Currently Egyptian patent laws only protect production processes and not end products. This will have to change, and the protection period will have to be extended to 20 years according to WTO requirements.

Egypt produces both agriculture and industrial chemicals including fertilisers, pesticides, detergents, paints and industrial coatings. The sector has remained stagnant in recent years, due in part to lower global prices for these products. Chemical enterprises, which are largely State controlled, make up 70% of the non-petroleum industry. One area of growth within the sector has been paint manufacturing. As construction has grown, paints have followed suit, and the rapid expansion of the market has allowed the private sector to gain an important foothold.

With 3.3 billion barrels of oil reserves and 40 trillion cubic feet of natural gas reserves, Egypt is a small but not insignificant hydrocarbons producer. Petroleum products account for 6-10% of GDP, depending on the price of oil. This makes petroleum by far the largest single industrial activity in Egypt, although it employs only a small portion of the workforce. For the time being, the sector remains under tight state control, but the private sector is taking tentative steps to establish a presence in downstream processing and distribution. Egyptian crude is very heavy and sells at a discount to Brent. For this reason, the majority of production is refined locally to meet domestic needs and to produce a higher value-added export product. *Total crude production is currently running around 40 million tons per year 800,000* barrels/day, and refinery output is close to 30 million tons. *Local consumption is in* the neighbourhood of 24 million tons, and the reminder is exported.

Rapid expansion in natural gas exploration and extraction is fast outstripping Egypt's ability to accommodate the growing output. For several years the government has worked to redirect local consumption from oil products to gas in order to take advantage of the cleaner and relatively more abundant resource. As new wells come on line over the next two to three years, however, the domestic market will have difficulty absorbing the additional output. This problem is compounded by the fact that the contracts between the government and the gas companies are on a 'take or pay' basis, meaning that Egypt is responsible for buying or otherwise disposing of the companies' allotted production shares. Either way, it means an initial outlay of hard currency. Since Egypt currently has no gas export facilities, it now finds itself in the paradoxical situation of being a net hydrocarbons importer with the majority of imports coming from its own soil. The government has been negotiating with Turkey, Jordan, and Israel to export gas through pipelines and/or in the form of liquefied natural gas. These projects are currently being given high priority, and it is expected that exports will begin within the next two to three years.

The Nile Valley and Delta are some of the most fertile and productive agriculture lands in the world. The regular irrigation precludes dependence upon erratic weather patterns, and the mild climate allows a year-round cultivation. Indeed, Egypt's favourable agriculture situation has been a primary reason for the country's historical importance. Agriculture currently accounts for 17% of GDP and employs 29% of the workforce. Approximately 95% of local production goes to domestic consumption. Primary crops include wheat, beans, barley, onions, rice, cotton, millet and sugar cane. There is also significant cultivation of maize and clover for animal feed as well as fruit and vegetables for the domestic market. In recent years, the relative economic importance of the sector has shrunk, and Egypt has become a large importer of several key agriculture goods including wheat, edible oils, tobacco, sugar, dairy products and meat. Indeed, despite its high productivity, Egyptian agriculture suffers from numerous problems. These include urban encroachment on fertile land, the environment impact of the Aswan High Dam, antiquated irrigation systems, inadequate transportation and cold storage facilities, and a complicated legacy of government regulations and price distortions.

The construction sector has benefited tremendously from the economic expansion of the 1990s. Both real estate development and large infrastructure projects have contributed to average real annual growth rates in excess of 8%. The sector now accounts for nearly 6% of GDP and employs nearly 8% of the labour force. State controlled giants, such as Arab Contractors and Mokhtar Ibrahim enjoy an estimated 40% of the market and obtain many of the high profile government projects. The larger private sector firms, such as Orascom Construction industries and AIC are also capable of competing for these contracts but are move focused on large private sector developments and projects in other countries. Beyond these large players, the industry is highly fragmented.

Real estate trade accounts for less than 2% of GDP. The sector witnessed strong growth while the economy was experiencing rapid expansion in the mid 1990s, but the upper end of the market become oversupplied. The problem is that the majority of real estate transactions are settled with ash or short-term credits. There is tremendous pent-up demand in the middle income market, but this can not be tapped until long-term financing is made available. The government is currently studying a mortgage law that would address this problem, but even after the adoption of such legislation, lending institutions will have to find proper mechanisms, including long-term sources of funding, to create a mortgage market.

Historically Egypt's banking industry has been completely dominated by the 'big four' public sector banks – National Bank of Egypt, Banque Misr, Banque du Caire and Bank of Alexandria. These institutions still control 60% of all deposits in the banking system and 49% of all loans. In recent years, the sector has benefited from privatisation of several joint venture banks and greater liberalisation of interest rates and fees. A number of foreign banks have also expanded their presence in Egypt to take advantage of the improved banking environment. For the most part, though, banking services remain quite basic. Egypt still has a cash economy. The vast majority of funds are held in simple demand and time deposits, and the majority of credit facilities are short-term loans. While a number of institutions are branching out into enhanced retail services, brokerage, fund management, insurance, merchant banking, corporate advising and underwriting, these markets remain under serviced and offer tremendous growth opportunities. The financial sector accounts for 4.4% of GDP and is growing at an average rate of more than 9% per year.

With its wealth of archaeological treasures, Egypt has long been a travel destination. Tourism cuts across several economic sectors including transportation, manufacturing, trade, personal services, restaurants and hotels, but it has been estimate that direct receipts from tourism account for about 5% of GDP. Nevertheless, the tourism industry falls well short of its potential due to poor infrastructure, inadequate facilities and weak marketing. Realising the tremendous opportunities in this sector, the government and private investors have embarked on projects in recent years to expand and improve Egypt's travel offerings. Much of this development is taking place outside of the traditional Nile Valley destinations as resorts are being established in the Sinai and on the Red Sea coast. These year-round beach resorts are aimed primarily at recreational tourists. Of course, the 1997 terrorist attack in Luxor dealt a serious setback to the industry, but tourist traffic has rebounded to record high levels. The industry is witnessing robust growth although prices remain somewhat constrained.

With a penetration rate of 7.4% in fixed lines and 1.4% for cellular services, Egypt's telecommunications market remains under serviced. The state owned Telecom Egypt has a switching capacity of 6.3 million fixed lines and 4.8 million operational lines. Approximately 75% of the lines are digital. Historically, Telecom Egypt has subsidised low fees on local communications with high fees on international calls. Recently, however, international rates were reduced as a first step towards conforming to international pricing norms. Telecom Egypt is slated for a partial privatisation in the near future. There are currently two private sector mobile phone services providers in the market – MobiNil and Click GSM. The mobile phone market has witnessed explosive growth since the service was first introduced three years ago.

Utilities are currently under state control, but the government has taken steps to prepare for the partial privatisation of electricity. To this end, generation, transmission and distribution activities have been split into separate companies and regions. The government has already signed three BOOT contracts for new generating facilities in Sidi Krier, Port Said and Suez. A public offering in one or more of the distribution companies is under consideration. Egypt derives 20% of its power from hydroelectric generation, primarily from the Aswan High Dam. Approximately 53% is derived from gas-fired steam plants, and 26% comes from combined cycle plants. The local abundance of gas makes Egyptian electricity some of the cheapest in the world.

Information technology is still a nascent industry in Egypt, but has taken on greater importance with the creation of a cabinet seat to oversee and encourage technological development. Internet services are growing fast, but prices remain high and quality of service is often poor. The software development sector benefits from a pool of well-qualified technicians and competitive labour costs. More than 100 start-up firms have been established in the past few years, and Egypt is recognised as a logical centre for software development in the region. Nevertheless domestic demand for such products remains soft and legal protection of intellectual property rights continues to pose a problem. Despite the incipient nature of the market, however, industry growth is currently estimated at a healthy 35% year.

Aside from a few retail department stores that were nationalised under Nasser's Socialist program, wholesale and retail trade is dominated by the private sector. Historically wholesale and retail trade has been organised in a co-operative framework similar to a guide system in which traders of a given commodity are all grouped together in a given district and products are generally subject to oligopolistic pricing. Although there are now some supermarkets, shopping malls and speciality shops, particularly in more affluent areas, these have not entirely supplanted the traditional system. The government has sought to privatise the state-owned department stores but as yet has had no success due to overstaffing, run-down facilities and unclear real estate titles.

Transportation accounts for approximately 3.5% of economic activity. Air and rail transportation are government controlled and road transportation is primarily private sector. There is a small private sector presence in charter flights. Recently, the government has also opened domestic routes for regularly scheduled flights by private airlines, but this has yet to take hold. Egypt Air, the government's flagship carrier benefits from regulated prices on international flights and practices preferential pricing on domestic routes for Egyptian nationals and local residents. The government has floated the idea of opening the railroads to private investment, but no concrete steps have been taken as yet. Generally, passenger rail is subject to social pricing policies. Road transportation in long-distance taxis and buses is cheap and abundant.

Personal services and government services each represent 8% of GDP. Suez Canal revenues continue to shrink in overall economic importance. Payments for passage now amount to less than 2.5% of GDP.

7.5.2 RECENT ECONOMIC DEVELOPMENT

For the past five years, Egypt's economy has been the best performer in the Middle East and North Africa regions, and one of the most attracting emerging markets world-wide. GDP growth has steamed ahead at annual rate of over 5%. An ambitious stabilisation and economic restructuring programme launched in 1990/91 is bearing fruit through resumed economic growth and macroeconomic stability. The real GDP growth is levelling off from 3.7% in 1990 to 6.0% in 1999 (see figure 7.1).

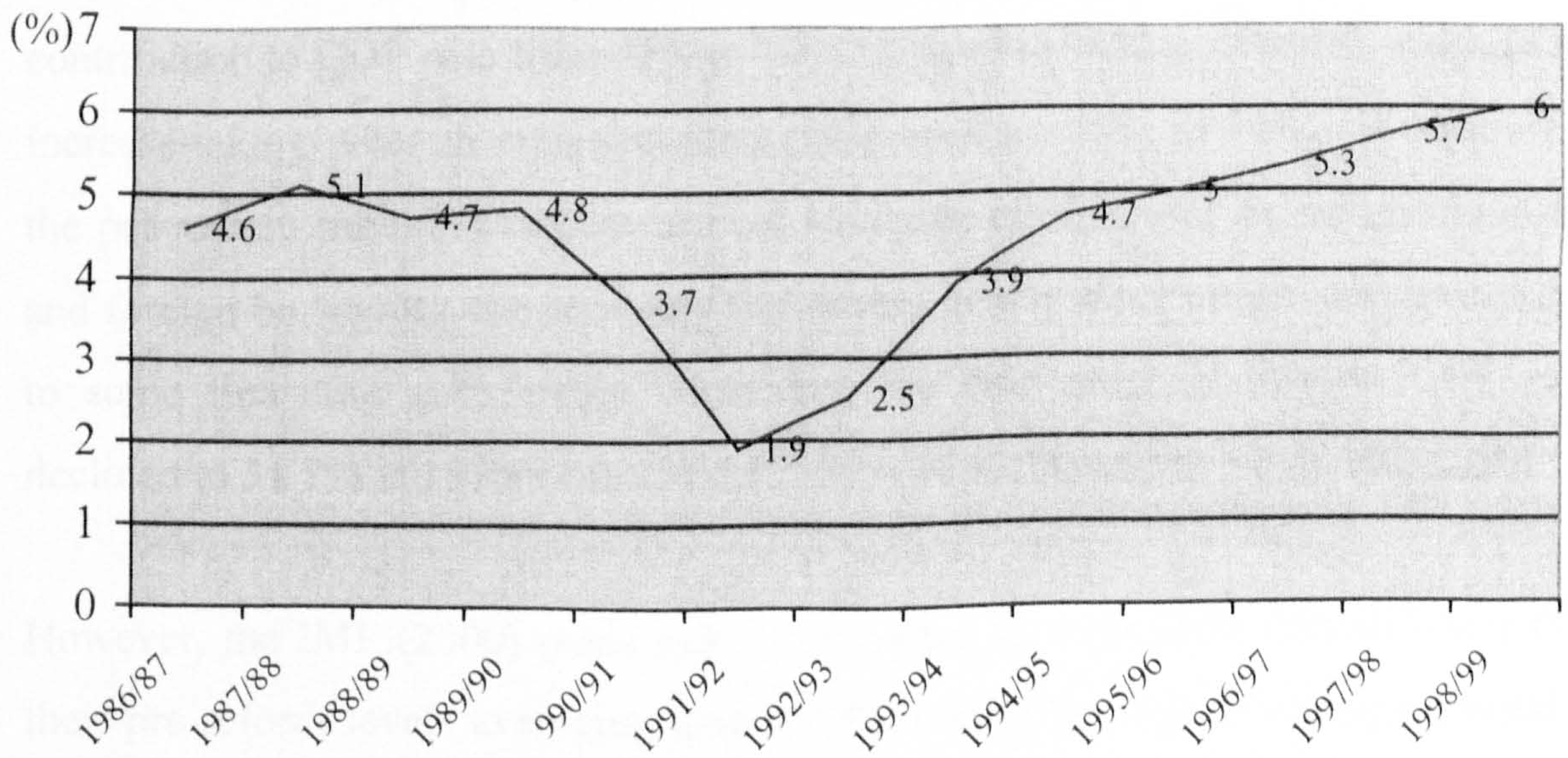


Figure 7.1: Real GDP Growth Rate (1986-1999)

Source: Ministry of Planning Egypt (2000)

The stabilisation programme led to a contraction in public spending and growth fell from 3.7% in 1990 to 1.9% in 1991/92. However, as private investment has responded to economic reform, especially since 1992/93, growth has accelerated (see table 7.2).

Economic growth appears to have resulted in an improvement in employment and per capita incomes. Unemployment has been a concern of successive governments. Increased economic growth has led to the creation of new employment opportunities mainly in manufacturing, social services and services. However, the government privatisation programme, which will shed some accedes labour employed by public sector companies before they privatised, is; likely to create new redundancies in the short run. Unemployment fell from 10% to 7.9% between 1992/93 and 1998/99. However the ability to sustain this level or to reduce it further remains a concern for the government, in particular the ability of the economy to absorb new labour-market entrants, which are projected to be around 2.8% each year (Ministry of Economy, Egypt, 2000). Per capita incomes rose from 767 dollars to an estimated 1,390 dollars between 1991/92 and 1998/99.

Growth is mainly attributed to higher investment demand since 1992/93. Gross domestic investment, which initially fell in response to contractionary policies, rose steadily to reach around 18% of GDP in 1996/97, mainly due to growing private sector investment and participation in the economy. Moreover, the private sector's contribution to GDP rose from 62% in 1992/93 to over 74% in 1998/99, much of the increase-taking place in manufacturing and petroleum 58% to 74%. In contrast to the per-reform period, when investment tended to be financed by deficit financing and foreign borrowing, the economy has started to rely more on private savings and to some financing and foreign borrowing, the total external debt to GDP ratio declined to 31.7% in 1998/99 from 78.9% in 1991/92 (see table 7.2) (CBE, 2000)

However, the IMF (2000) notes that current rates of investment remain lower than their pre-reform levels averaging almost 25% during the high investment period in the early 1980s and the developing country average; however, the investment composition has changed drastically, in favour of the private sector. The lower investment may in part be due to excess spare capacity and improved productivity resulting from economic reform. Nevertheless, the government believes that a further recovery in investment and growth in savings is crucial to accelerate growth. Reliance on foreign borrowing has declined since the early 1990s, and Egypt has started to invest increasingly out of domestic saving and workers' remittances. Domestic savings had declined from a peak of 21% during the pre-reform period to 16% in 1992/93 before beginning to rise again. The government is aiming at a savings rate of at least 25% (compared to around 20% in 1998/99), accompanied by higher investment, to sustain its target of 8% a year GDP growth.

Table 7.2: Economic Performance (1991-99)

Percentage (%)	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99
Real GDP Growth Rate	**1.9**	**2.5**	**3.9**	**4.7**	**5.0**	**5.3**	**5.7**	**6.0**
Gross Domestic Investment	18.2	16.2	16.8	16.9	16.9	18.1	19.5	20.0
Gross National Savings	17.0	16.4	16.6	16.9	16.6	18.3	21.3	20.60
Current Account Balance (Including Official Transfers)	6.4	4.8	0.8	0.7	-0.3	0.16	-3.0	-1.9
Trade Balance	**15.2**	**15.2**	**14.2**	**13.3**	**14.3**	**13.7**	**-14.7**	**-12.5**
Average Annual Inflation	21.1	11.1	9.1	9.3	7.3	6.2	3.8	3.8
Unemployment	9.2	10.0	9.8	9.6	9.2	8.8	8.3	7.9
Fiscal Deficit (%GDP)	6.4	3.5	2.1	1.2	1.3	0.9	1.0	1.3
Foreign Debt (%GDP)	77.9	64.6	59.9	54.8	45.9	38.0	34.0	31.7
Total Debt % Exports (G&S)	270.1	251.2	257.1	227.1	203.6	173.5	180.2	182.2
Debt Service Ratio	24.6	11.7	13.8	12.7	12.0	7.2	7.2	7.6
Reserves/Months Of Imports	12.1	16.1	18.8	16.4	15.7	15.7	14.3	12.8

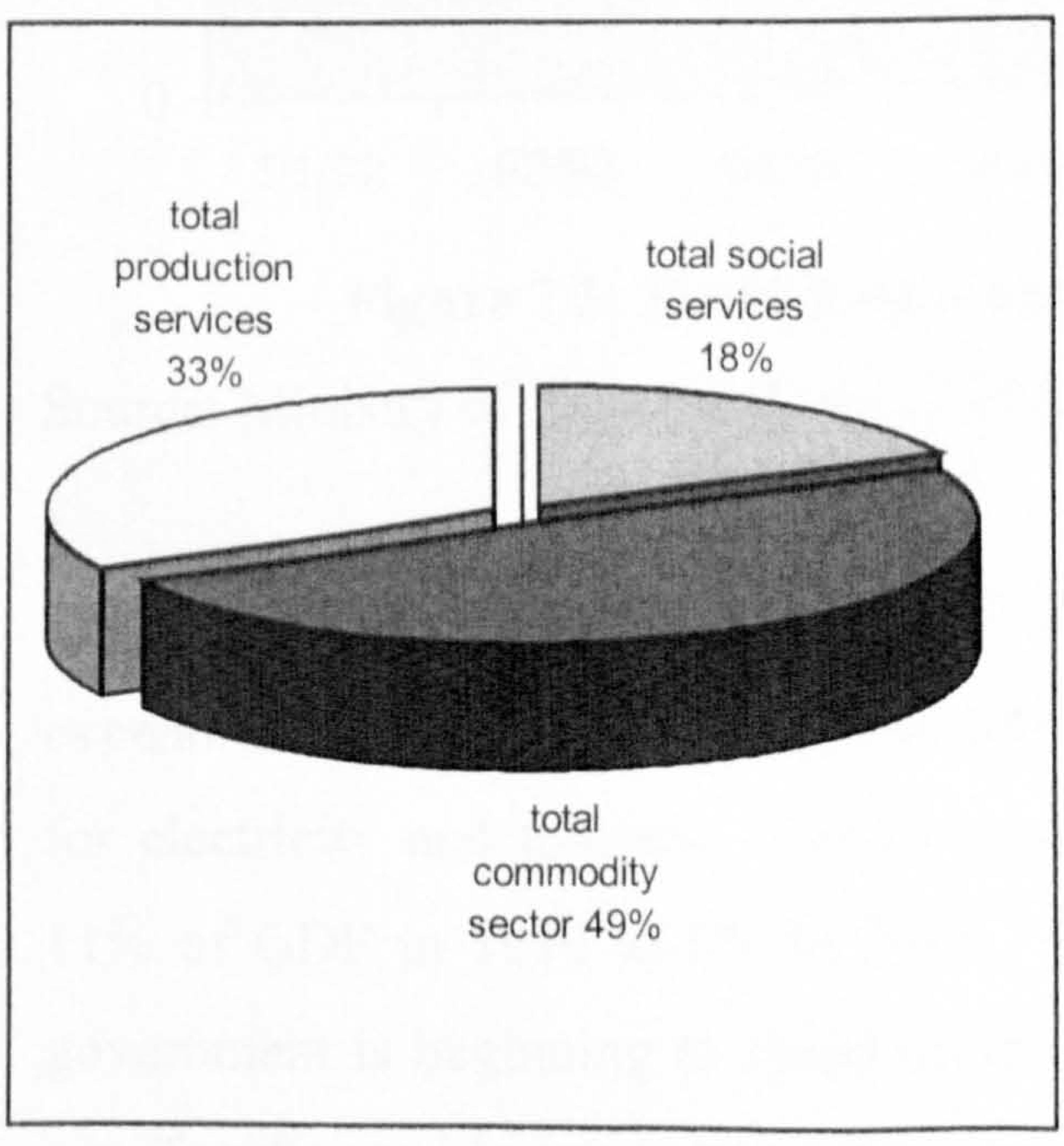
Source: Ministry of Finance, Ministry of Planning & Central Bank of Egypt (2000)

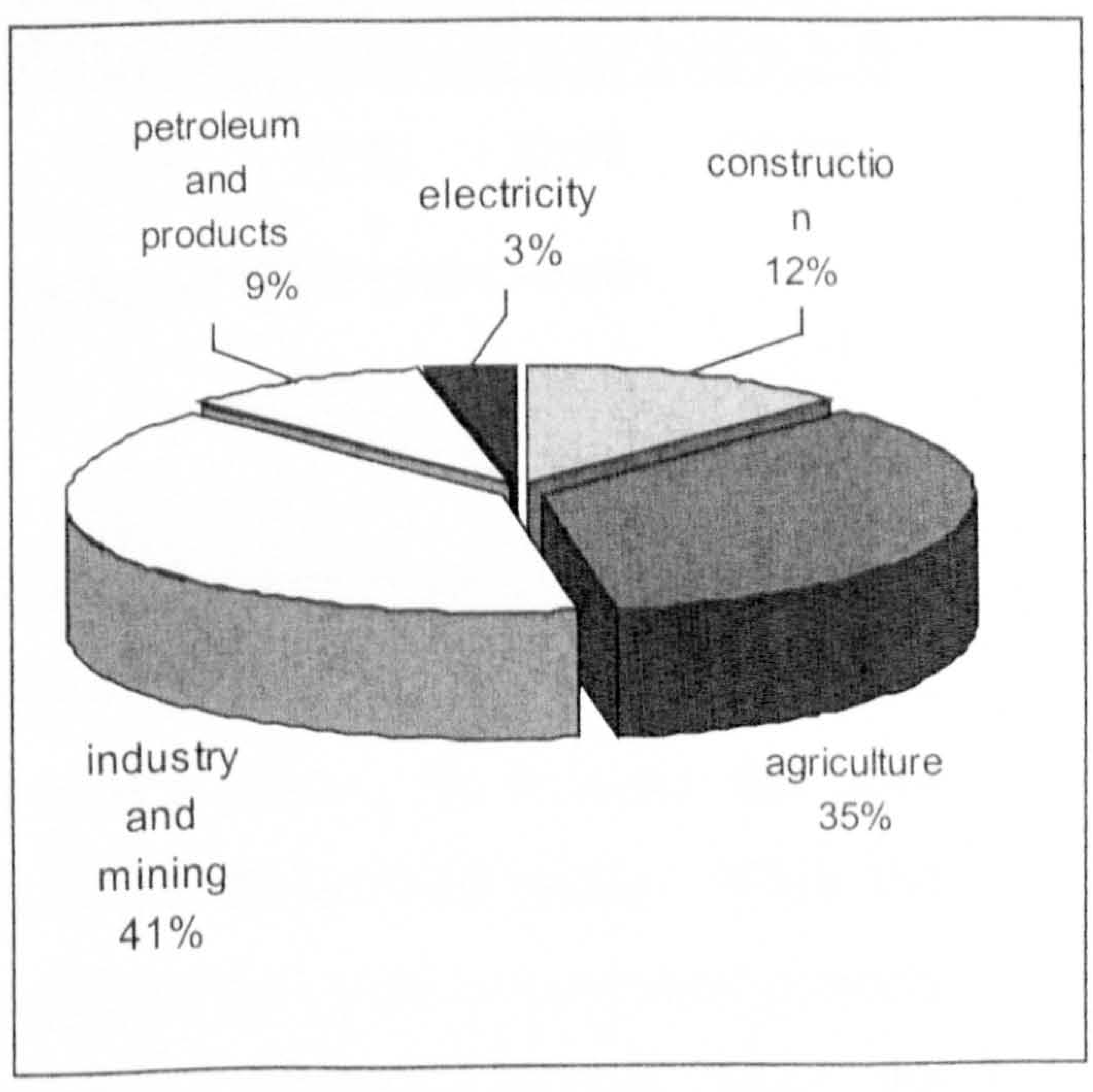
The sectoral composition of GDP shows a declining contribution by petroleum, from almost 10% of GDP in 1991/92 to 4.5 in 1998/99 (see table 7.3). The combined share of agriculture and manufacturing increased during this period from 33% to 36%, while the share of services remained relatively stable at some 51%. GDP growth, driven mainly by domestic demand, has shown up principally in the manufacturing and services sectors, although agriculture, with an average growth of 3% performed well between 1992/93 and 1998/99 (see figure 7.2).

Table 7.3: Sectoral Output As Percentage of Total GDP (1991-1999)

	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99
Total Commodity Sector	**49.9**	**49.8**	**49.6**	**49.1**	**48.9**	**49.5**	**49.8**	**49.0**
Agriculture	16.5	16.7	16.9	16.8	17.3	17.7	17.5	17.4
Industry mining	16.6	16.7	17.2	17.4	17.7	18.1	18.6	19.5
Petroleum products	9.9	9.5	8.2	7.9	6.9	6.6	6.4	4.5
Electricity	1.7	2.0	2.1	2.0	1.9	1.8	1.7	1.6
Construction	5.1	4.9	5.2	5.0	5.2	5.3	5.6	5.9
Total Production Services	**33.3**	**32.9**	**32.3**	**32.6**	**32.6**	**32.4**	**32.2**	**32.8**
Transportation	11.3	10.9	10.8	10.3	10.0	9.5	9.3	9.3
Trade finance and insurance	20.1	20.2	20.2	20.8	21.1	21.3	21.6	22.3
Hotels and restaurant	1.8	1.8	1.4	1.5	1.5	1.6	1.2	1.3
Total Social Services	**16.8**	**17.3**	**18.0**	**18.3**	**18.5**	**18.1**	**18.1**	**18.2**
Housing and real estate	16.8	17.3	18.0	18.3	18.5	18.1	18.1	18.2
Utilities	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4
Social insurance	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Government services	7.1	7.4	7.8	7.9	8.0	7.9	7.9	7.9
Social and personal services	7.5	7.7	8.0	8.2	8.2	8.0	7.9	7.9

Source: CBE (2000c)





Total **Total Commodity Sector**

Figure 7.2: Composition of GDP (1998/99)

Source, Ministry of Planning (2000)

7.6 FISCAL STABILISATION

The government's success in balancing its books has been a key achievement of economic reform. As recently as 1990/91, the budget was running a deficit equivalent to 17% of GDP. By 1994/95 this had fallen to 2% and since 1997 has hovered around 1% of GDP, despite strains on revenues from falling oil prices and stagnant Suez Canal revenues. At the same time, the government trimmed the state budget's share of GNP from some 32% in 1994 to barely 25% in 1998. Commitment to maintaining this kind of fiscal performance has been crucial to improving the government's credibility. This suggests that fiscal policy will remain tight well into the future (IMF, 2000) (see figure 7.3).

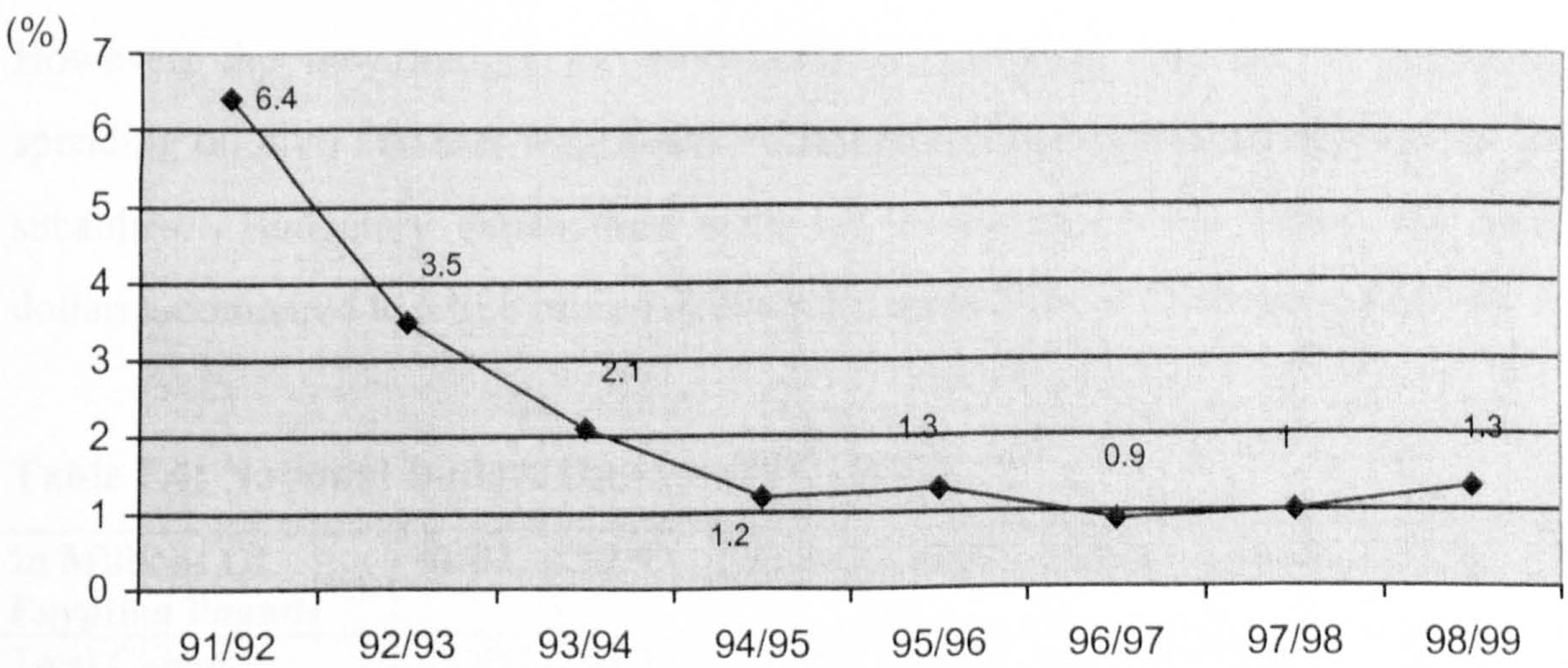


Figure 7.3: Fiscal Deficit Percentage of GDP (1991-1999)

Source: Ministry of Finance, Egypt (2000).

The decline in the budget deficit has been mainly due to restraints in government expenditure, including a reduction of subsidies and transfers and a cut in investment for electricity and tourism. Government capital spending, for example, fell from 11% of GDP in 1990 to 6% in 1998. This share should hold steady. While the government is beginning to spend more on a select few large development projects e.g. Toshka, and in upgrading vital services such as the state education system, the private sector is taking on more and more of the responsibility for providing basic infrastructure (see table 7.4) (Minister of Economy, Egypt, 2000).

Defence spending, meanwhile, was cut from 4.4% of GDP in 1991 to 2.8% in 1999. Outlays on consumer subsidies fell even more dramatically, from 5.6% of GDP in 1991 to 1.6% in 1998. Only a few essential commodities, such as bread, sugar and cooking oil, are still subsidised. Egypt's increased payments on foreign debt were also substantially reduced as a result of debt forgiveness and rescheduling in 1991. The once burdensome bill for interest payments on external debt has dropped, from nearly 3% to a tolerable 1% of GDP.

While maintaining a fair degree of austerity, the government has managed to keep public sector salaries a head of inflation. This is significant, because unrealistically low salaries and overstaffing have been a major cause of bureaucratic inefficiency. The government wage bill accounts for around 6% of GDP, and is likely to hold steady at that level.

However, the new budget for 1999/2000 proposed an increase in government spending on civil services wages and infrastructure, and continued support for food subsidies. Budgetary expenditure were set to rise to LE102 billion (30 billion dollars), compared to LE88 billion in 1998/99, some 29% of GDP (see table 7.4).

Table 7.4: National Budget Outlays (1991-1999)

In Millions Of Egyptian Pounds	**91/92**	**92/93**	**93/94**	**94/95**	**95/96**	**96/97**	**97/98**	**98/99**
Total Current Expenditure	33,051	40,416	45,912	46,933	51,196	53,030	55,289	60,683
Wages And Salaries	8,029	9,803	11,096	12,519	14,045	15,368	17,025	19,562
Pension Payments	2,763	3,526	3,914	4,146	4,256	4,300	4,647	5,509
Material And Supplies	1,766	2,423	2,857	2.986	3,214	3,520	3,734	3,721
Interest Payments	9,510	13,309	16,498	14,790	16,027	15,451	14,943	16,406
Domestic Debt	6,359	9,315	11,816	11,177	12,231	12,337	12,219	14,081
Foreign Debt	3,151	3,994	4,682	3,613	3,796	3,114	2,724	2,325
Subsidies And GASC Debt	4.470	3,859	3,418	3,639	4,075	4,379	4,410	4,564
Defence	4,850	5,572	5,873	6,410	6,954	7,373	7,772	8,107
Social Fund	0	150	333	520	515	645	650	500
Other	1,663	2,122	2,256	2,443	2,625	2,639	2,758	2,814

Source: Ministry of Finance, Egypt (2000).

The impact of the declining budget deficit has been positive on interest rates and the availability of credit. Crowding out of the public sector that had resulted in low historical rates of private investment was reduced; as a result credit doubled, to the private sector in particular, between 1992/93 and 95/96, boosting private sector investment. In addition, consolidation of the fiscal deficit enabled public sector savings to increase from 2.5% to 3.7% between 92/93 and 95/96 (see table 7.5).

Table 7.5: Classification of Public Investments (1990- 1999)

In Millions Of Egyptian Pounds	90/91	91/92	92/93	93/94	94/95	95/96	96/97	97/98	98/99
Total Public Investment	**15,067**	**15,746**	**11,097**	**10,659**	**11,299**	**12,581**	**14,070**	**15,635**	**25,321**
Social Sector	**2,072**	**2,060**	**2,263**	**2,565**	**3,035**	**3,455**	**4,127**	**5,127**	**8,035**
Education	653	536	540	1,148	1,351	1,449	1,982	2,009	2,985
Health	182	161	106	86	270	289	361	770	1,254
Public Services	1,211	1,332	1,564	1,263	1,364	1,657	1,694	2,271	3,739
Other	26	31	53	68	50	60	90	77	57
Infrastructure/ Construction	**4,777**	**6,408**	**6,437**	**5,976**	**5,864**	**6,702**	**7,446**	**7,457**	**10,997**
Constructions	1,855	2,067	2,220	2,450	2,628	2,681	3,124	3,308	4,136
Electricity	1,509	2,544	2,412	1,915	1,804	1,891	1,999	1,790	3,085
Transportation And Telecommunications	1,413	1,797	1,805	1,611	1,432	2,130	2,323	2,359	3,776
Economic Services	**1,659**	**1,697**	**1,532**	**1,935**	**2,250**	**2,312**	**2,399**	**2,882**	**5,868**
Agriculture And Irrigation	731	968	1,183	1,175	1,590	1,715	1,781	2,191	4,953
Industry And Mining	928	729	349	760	660	597	617	691	915
Other Investments	1,669	1,683	865	183	150	112	99	169	421
Public Enterprise Investments	**4,890**	**3,898**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**

Source: Ministry of Finance, Egypt (2000)

On the revenue side, the government has succeeded in expanding the range of its sources of income, while reducing its dependency on volatile sources such as oil sales and Suez Canal transit fees. Only introduced in 1991, retail sale taxes in 1999 accounted for 19% of total revenues. Plans to introduce VAT have been delayed, however.

Fiscal revenues are mainly comprised of tax revenue, including income tax receipt and customs tariffs (with the latter accounting for around 3.2% of GDP) (tax revenues account for about two third of reported government income), and contributions from the Egyptian General Petroleum Company (EGPC) and the Suez Canal Authority (around 20% of total government revenue). Egypt raises relatively less than neighbouring countries through taxes (around 19% of GDP in 98/99). This is partly because of the exclusion of wholesale and retail trade and a number of services from the general sales tax, and because of its relatively low standard rates of 10% (World Bank, 2000c).

Corporate and income taxes still make up the largest component of revenues, accounting for 22%. Although personal taxes have been streamlined and lowered, there is still great room for improvement here, and collection rates are likely to rise. Customs duties, which currently account for a high 13% of revenues, are likely to grow less important as free-trade agreements come on stream. The revenue share of transferred profits from the Egyptian Petroleum Company, the Suez Canal, and other independent state authorities, will follow the same downward trend. Since 1991, their proportion of government income has fallen from 20% to under 15%.

Personal and corporate income taxes contribute around 3.6% of GDP, compared to an average of 5.4% for neighbouring countries; this is due, in part, to the extensive corporate tax incentives provided by Egypt. Egypt has plans to widen the base of the sales tax by including wholesale and retail trade, although implementation has been delayed. Delays in completing tax reform may have wider implications for further reductions in tariffs, given the importance of customs revenues in overall government revenue (see table 7.6 and 7.7).

Table 7.6: Summery of National Budget Operation (1990-2000)

In Millions Egyptian Pounds	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Total Revenues	**30,710**	**43,385**	**46,703**	**52,567**	**55,719**	**60,983**	**64,498**	**67,963**	**73,279**	**76,731**
Tax Revenues	15,504	24,285	27,334	31,373	34,279	38,249	40,518	43,962	48,096	50,869
Transferred Profit	6,979	8,863	9,364	9,070	10,542	11,133	11,423	10,780	9,501	10,856
Other Non-Tax Revenues	1,393	2,528	4,322	6,619	5,724	5,715	5,867	5,293	5,165	5,165
Non-Central Government Revenues	6,834	7,709	5,683	5,505	5,174	5,796	6,690	7,293	10,521	9,841
Total Expenditure	**50,398**	**50,963**	**51,883**	**56,264**	**58,256**	**63.889**	**66,826**	**70,783**	**86,009**	**89,062**
Current Expenditure	27,400	33,051	40,614	45,912	46,933	51,196	53,030	55,289	44,282	49,670
O/w Domestic Interest Payments	4,176	6,359	9,315	11,816	11,177	12,231	12,337	12,219	14,081	16,435
Foreign Interest Payments	2,870	3,151	3,994	4,682	3,613	3,796	3,114	2,724	2,325	2,300
Investment Expenditure	15,067	15,746	11,097	10,659	11,299	12,581	14,070	15,635	25,321	20,657
Overall Balance	**-19,688**	**-7,578**	**-5,520**	**-3,697**	**-2,537**	**-2,996**	**-2,328**	**-2,820**	**-12,730**	**-12,331**
Total Financing	**19,688**	**7,578**	**5,520**	**3,697**	**2,537**	**2,996**	**2,328**	**2,820**	**12,730**	**12,331**
Foreign Financing	14,416	2,981	298	524	-278	-1,340	-1,575	1,328	1,914	1,731
Domestic Financing	5,272	4,597	5,222	3,173	2,815	4,336	3,903	4,148	16,549	14,062
Over All Balance As % Of GDP (%)	**-20.0**	**-6.4**	**-3.5**	**-2.1**	**-1.3**	**-1.3**	**-0.9**	**1.0**	**4.2**	**3.7**
GDP	**98,664**	**118,288**	**157,038**	**175,117**	**200,408**	**224,917**	**253,458**	**277,238**	**304,993**	**330,211**

Source: Ministry of Finance, Egypt (2000)

Table 7.7 National Budget Program Vs Actual (1991-1999)

In Millions Of Egyptian Pounds	91/92	92/93	93/94	94/95	95/96	96/97	97/98	Pre-June 98/99
Program Target								
Overall Balance	-8,430	-9,342	-3,815	-2,560	-2,850	-1,917	-2,820	-12,73
As A %Of GDP	**-6.3**	**-4.5**	**-2.6**	**-1.5**	**-1.3**	**-0.8**	**-1.0**	**-4.2**
Primary Balance	1,905	8,616	12,674	12,974	13,437	13,347	12,123	3,676
As A %Of GDP	**1.4**	**6.2**	**8.0**	**8.0**	**6.0**	**5.3**	**4.4**	**1.2**
Actual Figures								
Overall Balance	7,578	-5,520	-3,697	-2,537	-2,996	-2,328	-2,820	
As A %Of GDP	**-5.4**	**3.5**	**-2.1**	**-1.2**	**-1.3**	**-0.9**	**-1.0**	
Primary Balance	1,932	7,789	12,801	12,253	13,031	13,123	12,123	
As A %Of GDP	**1.6**	**5.0**	**7.4**	**6.1**	**5.2**	**5.2**	**4.2**	

Source: Ministry of Finance, Egypt (2000)

7.7 BALANCE OF *PAYMENT*

Egypt has traditionally run a large merchandise trade deficit, which has been balanced by net inflows from workers' remittances and services, especially tourism and Suez Canal dues. The trade deficit grew 6.2 billion dollars in 91/92, 9.8 billion dollars for 96/97. According to CBE data (2000b), 1997/98 was something of an anomaly, with a slump in oil exports, tourism revenues and portfolio investment leading to a sharp decrease. The trade deficit in 1997/98 reached 11.8bn US dollars or 14% of GDP and 12.5bn US dollars or more than 14% of GDP in 1999. Moreover, the current account deficit grew to 2.4bn US dollars, or 3.0% of GDP. By 1998/99 the current account deficit declined to 1.7bn US dollars, or 1.9% of GDP (Ministry of Planning, 2000).

While imports have increased steadily, by over 10% a year since 93/94, export growth has been erratic and closely dependent on petroleum export revenues, which account for some 50% of the total. Despite government efforts to foster export activity in recent years, exports remain a fairly small part of the economy. In the period 91/92 to 93/94 exports declined, but then rose by some 52% in 94/95, with the surge largely due to record cotton crops; however, export growth has been more subdued since, and more dependent on petroleum exports.

Exports in recent years may also have been affected by the real appreciation of the Egyptian pound since economic reform was initiated; the exchange rate of the Egyptian pound was unified in October 1991. Responsibility for exchange rate policy lies with the government of Egypt and is administrated by the Central Bank of Egypt in consultation with the Minister for the Economy.

The external value of the Egyptian pound is determined in the foreign exchange market; the Central Bank of Egypt, however, intervenes if the value of the pound fluctuates above or below the bands specified by the government. In late 1998, the band was 3% around a central rate of about LE 3,39 per US dollar. Intervention currency controls and foreign currency transfers are unrestricted although Egypt has not accepted the obligations of the IMF's article VIII, sections 2,3 and 4. There is also a multiple currency practice, which arises from the special exchange rate for liquidating accounts under terminated bilateral payments restrictions (CBE, 2000b).

Although the nominal exchange rate has been stable around LE 3.32 to 3.39 per US dollar since 1991, inflation differentials with major partners have resulted in an appreciation of the pound's real effective exchange rate (REER), especially since 1994/95, suggesting a possible negative impact on the competitiveness of Egyptian exports.

The large trade deficit is offset, in part, by the net services balance which, after declining from 4.5 billion US dollars in 91/92 to 3.7 billion dollars in 93/94, increased steadily to reach 6.2 billion dollars in 96/97. However, since 1997/98 the net services balance start to declining to reach 4.9 billion US dollars and 5.9 in 1998/99. Tourism revenues, which contracted in 97/98 by around 28%, are increased to a great extent to reach 30% in 1999. Another important source of revenue is workers remittances, which grew significantly between 91/92 and 92/93, to 3.8 US billion dollars, but averaged around 3.2 billion a year in the subsequent period to 96/97. CBE data for 97/98 shows a slight increase in remittance to some 3.5 billion dollars.

The current account surplus has been declining and showed a deficit of over 2% in 97/98, from a surplus of almost 1% in 96/97 and 1.7% in 1999 (see figure 7.4).

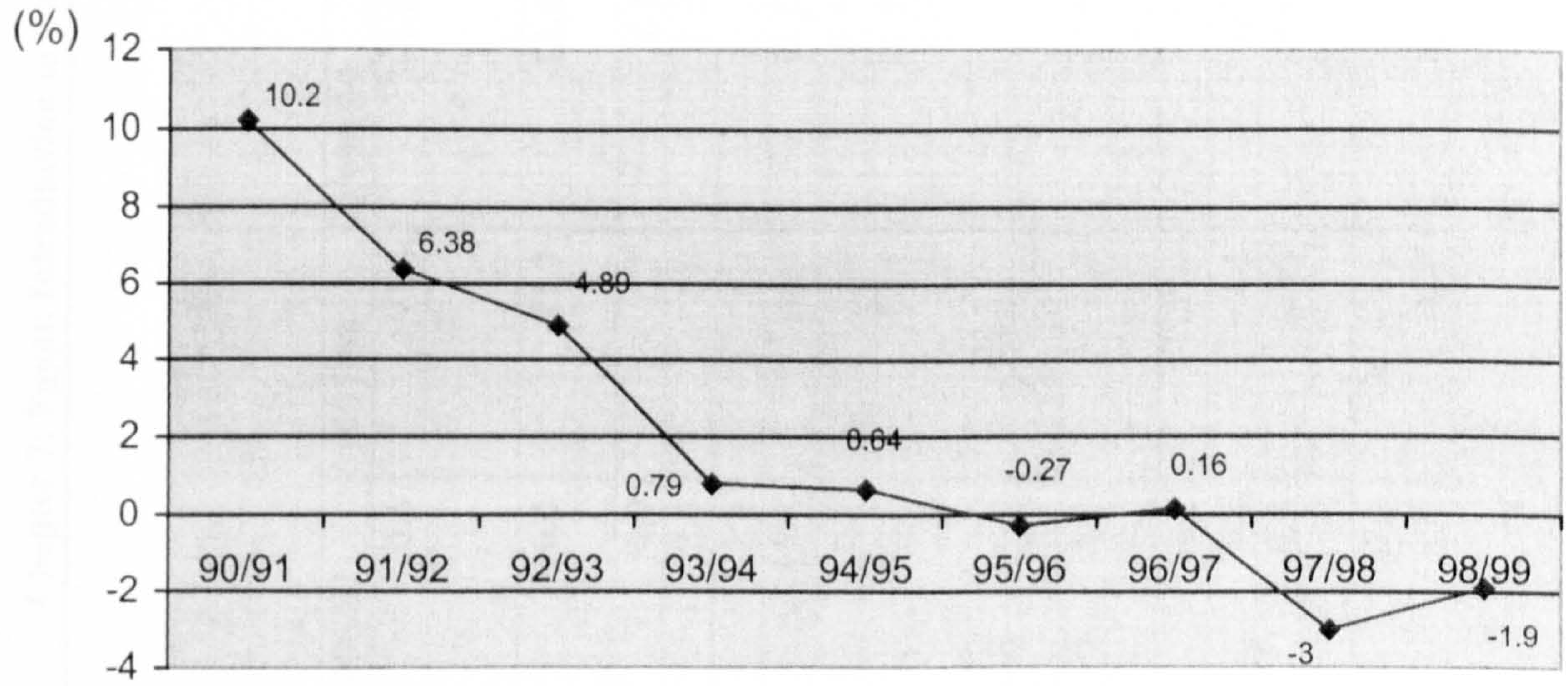


Figure 7.4: Current Account % GDP (1990-99)

Source: Central Bank of Egypt (CBE) (2000b)

Egypt's overall balance of payments had been positive but declined between 91/92 and 95/96 from 6 billion US dollars to 0.6 billion US dollars. There was an increase in the balance to 1.9 billion dollar in 96/97, mainly due to an increase in net portfolio investment inflows; a small negative balance of 0.1 billion dollars were registered in 97/98, with net portfolio outflows in the second and third quarters. Initial improvements in the balance of payments also resulted from one-off, exogenous factors such as debt forgiveness and rescheduling, which improved the balance of payments on a flow basis by around 15.5 billion dollars between 91/92 and 95/96, an annual improvement of around 2.2 billion dollars. A substantial build up of official reserves, equivalent to almost 17 months of imports in 96/97, also provides Egypt with some degree of insulation from volatile changes in financial flows (see table 7.8).

Table 7.8: Balance of Payments (1991-99)

US$ billion

	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99
Current account balance including official transfers	**4.9**	**1.8**	**0.4**	**0.4**	**-0.2**	**0.6**	**-2.8**	**-1.8**
Merchandise Trade balance	**-6.2**	**-7.0**	**-7.3**	**-7.8**	**-9.5**	**-10.2**	**-11.7**	**-12.5**
Exports	3.9	3.7	3.3	5.0	4.6	4.9	5.1	4.4
Petroleum	1.9	2.1	1.8	2.2	2.2	2.6	1.8	1.0
Other exports	1.9	1.6	1.6	2.8	2.4	2.8	3.4	3.5
Imports	10.1	10.7	10.7	12.8	14.1	14.8	16.9	16.9
Services net balance	**4.5**	**3.6**	**3.7**	**4.0**	**5.8**	**6.2**	**4.6**	**5.9**
Receipts	**8.2**	**8.3**	**8.7**	**9.6**	**10.6**	**11.2**	**10.4**	**11.2**
Receipts of Suez Canal dues	2.0	1.9	2.0	2.1	1.9	1.9	1.8	1.7
Tourism	2.5	2.4	1.8	2.3	3.0	3.7	2.9	3.3
Payments net balance	**3.7**	**4.8**	**5.0**	**5.5**	**4.8**	**5.1**	**5.7**	**5.0**
Workers remittances	3.0	3.8	3.2	3.3	2.8	3.3	3.5	3.2
Officials transfers net	1.3	1.4	0.8	0.9	0.7	0.9	0.9	1.1
Capital account	**1.6**	**1.8**	**2.5**	**0.4**	**1.0**	**2.0**	**3.4**	**1.0**
Medium and long term loans	**0.3**	**0.3**	**0.4**	**0.3**	**-0.08**	**-0.1**	**-0.05**	**-0.4**
Foreign direct investment	1.2	1.1	1.3	0.8	0.6	0.8	1.1	0.7
Overall balance	**4.0**	**4.3**	**2.1**	**0.8**	**0.6**	**1.9**	**-0.1**	**-2.1**

Source: Central Bank of Egypt, Annual Report (2000a)

7.8 TRENDS IN FOREIGN INVESTMENT

Egypt has become an increasingly attractive market for direct investment in recent years. A wealth of incentives, plus a large local market and a good location for prospective exports have served to lure a growing number of international firms. Close ties with the Arab World have also brought in very significant investments, particularly from the Gulf area.

EFG-Hermes (2000) points out that it is widely believed that total foreign investment in Egypt is far higher than the sums that appear in official accounts. Indeed, the statistical confusion is such that the government has appointed a task force to unscramble the data. The source of the problem appears to lie in poor co-ordination between different agencies. The Ministry of Petroleum and Mineral Resources, for example, keeps separate accounts for the very substantial foreign investment in its sector, while the General Organisation for Investment and Free Zones (GAFI) keeps tabs on Investment Law Companies, and the Companies authority monitors investments under the Companies Law.

Foreign investment flows, the bulk of which was foreign direct investment FDI until 1996/97, have remained volatile and mainly restricted to the non-tradable sectors. According to Central Bank data, the total stock of FDI declined from 1.3 billion in 1993/94 to 0.8 billion in 96/97, before rising to around 1.1 billion in 1997/98, up 30% from the previous year. As a percentage of GDP, foreign investment averaged around 1.3% a year between 1992 and 1996, peaking at some 2.4% in 1994, before declining again (see figure 7.5).

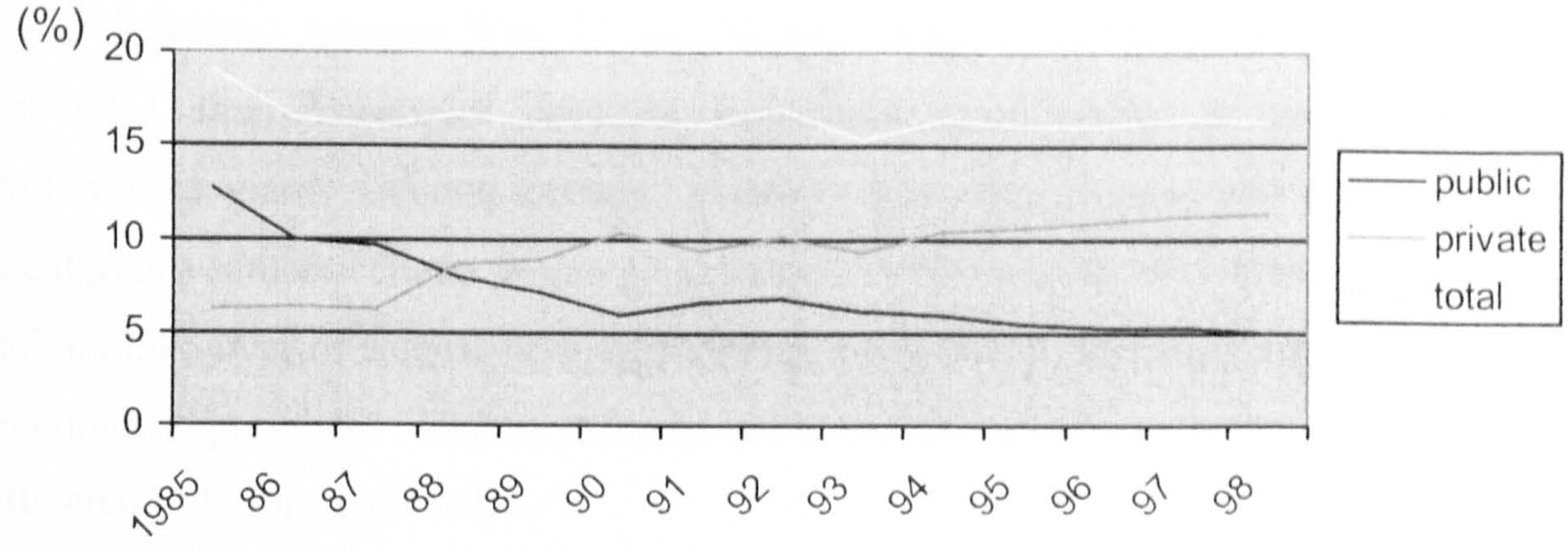


Figure 7.5: Investment Rates, 1985-98 Percent of GDP (1985-97)
Source: WTO (1999k)

However, a more accurate estimate of investment may be gleaned from GAFI's estimation of the total foreign participation in issued capital for Investment Law companies established in the two years to end-1998, which stood at US$6 billion. Considering that in the telecome sector alone, Egypt's two rival mobilephone operators –both majority foreign-owned-paid a total of 1.3bn US dollar in licensing fees during 1998, the higher figures are clearly believable.

The main foreign investor in Egypt is the United States, which accounted for around 84% of FDI inflows in 1997/98, down slightly from 1995/96, followed by the European Union. Investment by neighbouring countries, notably Saudi Arabia, has begun to increase in recent years, although this still forms under 5% of total FDI inflows. The main sectors in which FDI has taken place include petroleum and gas, tourism and financial services.

The petroleum sector has traditionally attracted the highest share of investment. Major players such as BP Amoco, ENI and Shell all have substantial fixed investments in Egypt. Although oil reserves are declining, the Nile Delta's very promising gas fields are likely to bring in strong investment for a number of years to come – one international consortium is committed to spending 500m US dollars to develop two offshore concessions, while export agreements signed with foreign firms in 1997 alone called for the spending of over 200m US dollars.

Faster growth in investment has been seen in other sectors. Multinationals such as Lever Brothers, Johnson Wax, Union Carbide, Colgate-Palmolive and Nestle have expanded their consumer products operations considerably in recent years. Automotive giants General Motors, Mercedes-Chrysler, Nissan, and others have local joint ventures. Glaxo Welcome expanded its presence in 1998 with a 177m US dollars take-over of a local firm, while other international pharmaceutical giants all maintain a presence. Heavy industry, with the exception of cement, has so far attracted little foreign interest.

The faster growth in foreign investment has come in the financial sector. Major international insurance firms are eyeing this underdeveloped market. Several foreign banks have taken over local partners, most recently Barclays, which acquired control of its 25-year old joint venture Banque du Caire Barclays. Investment banks such as Flemings and ING Barings are also extremely active with local partners.

Egypt is likely to remain very attractive to direct investment for some time to come. With its fast growing economy developing from a low base, the country still offers many opportunities.

Most existing local firms suffer from poor management skills, opening the way for the entry of newcomers with better expertise. In addition, the planned expansion of the privatisation programme to include utilities such as electricity, ports and fixed-line telecomms should generate sustained interest. Substantial FDI has already begun to flow into power generation and cellular telephony.

Although FDI formed the bulk of foreign investment inflows into Egypt until 1996/97, its share in total foreign investment has declined as a result of increased portfolio investment. Several factors have contributed to a rise in portfolio investment, which grew from 20 million dollars in 1995 to 1.5 billion in 1996/97; these include a relaxation in investment regulations, and stepped-up privatisation, a significant amount of which has taken place through the stock market. Portfolio investment, however, has tended to be extremely volatile. After peaking in 1996/97, provisional data for 1997/98 show negative net portfolio investment inflows of 250 million dollars, partly due to the general uncertainty surrounding investment in emerging market economies in the aftermath of the Asian financial crisis.

With the passage of a new law of Investment Guarantees and incentives Law 8/1997, which consolidates investment rules and incentives and liberalises investment. FDI in Egypt is expected to grow. Egypt's privatisation programme, which has recently been accelerated, as well as a decision to allow private and foreign investment in several services through Build-Own-Operate-Transfer BOOT schemes are likely also to attract both foreign direct and portfolio investment.

7.8.1 RISK RATING AND COMPETITIVENESS INDICATORS

Country risk ratings are becoming important indicators for investors, creditors and government in deciding on a country's overall stability. Table 7.9 presents the credit rating of several Middle East and North African countries (MENA) that are likely to attract foreign investment, as measured by major international rating services.

The composite International Country Risk Guide (ICRG) is an overall index based on 24 components of risk grouped into three major categories:

- Political;
- Financial;
- Economic.

The higher the index the lower the risk of the country.

The Institutional Investor Credit ratings are based on information provided by leading international banks. Responses are weighted according to the bank's worldwide exposure and level of sophisticated country analysis. Countries are rated on a scale of 0 to 100, the higher the rate, the more credible the country in terms of return on investment.

The Euromoney country creditworthiness ratings are based on nine weighted categories that assess country's risk (economic performance, political risk, debt and access to financial and capital markets). The ratings are scaled from 0 to 100 and reflect the opinion of economists and political analysts that are provided with macroeconomic data. The higher the rating the lower the risk in investing in a given country (see table 7.9)

Table 7.9: Credit Risk rating of Selected MENA Countries (1998)

	ICRG risk Rating		Institutional Investors		Euromoney Rating	
	1996	1998	1996	1998	1996	1998
Algeria	59.0	56.5	22.8	25.8	17.7	26.3
Egypt	**67.5**	**70.8**	**35.1**	**43.2**	**45.7**	**43.1**
Iran	72.0	69.5	24.7	29.3	35.6	23.4
Iraq	35.0	45.8	9.1	7.0	9.4	6.8
Kuwait	85.0	78.3	72.1	57.4	84.3	77.7
Lebanon	62.5	56.3	27.2	31.8	44.3	34.1
Libya	63.5	64.3	27.9	28.6	17.1	21.6
Morocco	71.5	72.5	39.3	42.4	-	41.0
Oman	92.5	75.0	83.1	53.4	95.0	61.5
Saudi Arabia	73.0	73.0	55.1	55.7	72.6	63.7
Sudan	62.5	43.3	33.7	7.2	43.0	7.1
Syria	66.5	40.5	24.5	24.5	25.7	24.2
Tunisia	73.0	72.5	45.5	49.0	61.6	45.7
Turkey	57.0	52.3	41.1	37.8	57.5	38.5
UAE	76.0	78.3	61.2	61.8	75.8	79.4
Yemen	64.0	67.0	-	-	27.9	-
Low & Middle income	**-**	**64.0**	**-**	**26.8**	**-**	**25.6**
MENA	**-**	**70.5**	**-**	**34.3**	**-**	**37.2**
East Asia % Pacific	**-**	**66.7**	**-**	**32.9**	**-**	**27.5**
Europe & Central Asia	**-**	**65.9**	**-**	**33.8**	**-**	**23.7**
Latin Americas & Caribbean	**-**	**67.0**	**-**	**33.7**	**-**	**36.3**
South Asia	**-**	**62.8**	**-**	**25.7**	**-**	**21.0**
Sub-Saharan Africa	**-**	**60.8**	**-**	**18.5**	**-**	**20.2**
High Income	**-**	**83.3**	**-**	**80.4**	**-**	**91.3**
Europe	**-**	**84.2**	**-**	**82.3**	**-**	**94.7**
World	**-**	**67.7**	**-**	**35.3**	**-**	**29.0**

Source: World Bank (1999c)

The MENA region performed well in terms of improving on its risk ratings criteria despite the persisting tension that the region has experienced. MENA average risk ratings compare well with the world average. The MENA ICRG average index rated 70.5 in 1998 compared to an average world rate of 67.7%. In terms of institutional investors credit, MENA rated 34.3 compared to a rate of 35.3% for the world. Finally, the Euromoney credit rating gave MENA a score of 37.2 compared to 29 for the world.

Those three things are highest for MENA compared to other Middle and Low-income regions, e.g. East Asia and Pacific, Europe and Central Asia, Latin America and Caribbean, South Asia and Sub Saharan Africa.

Eight countries can be considered responsible for the high rates achieved by the MENA. Despite a slight decrease between 1996 and 1998 due to a dramatic fall in oil prices, in 1998, Gulf countries achieved the highest risk ratings scores in the region: Kuwait, Oman, Saudi Arabia and United Arab Emirates. These oil producers enjoy a high per capita and GDP growth that attracts private investment.

Egypt's ratings improved between 1996 and 1998 for the three risk ratings indices, reflecting the government's effort to improve the business climate, maintain a stable macroeconomic environment, open the economy to foreign investors and pursue the process of privatisation, attracting more FDI. Despite these efforts, a dollar liquidity problem faced the market in 1999. Interest rates and investment bonds were raised by 50 points and the Central Bank of Egypt started injecting dollars to the market.

An index assessing the business environment is constructed by the Economist Intelligence Unit (EIU) to rank each country according to the quality or attractiveness of its business environment. The survey covers 60 countries of the world and the scores are assigned on a scale of 1 (denoting worst environment for business) to 10 (denoting best environment for business).

Seven MENA countries are included in this measurement. Table 7.10 shows that the overall ranking of the seven MENA countries, excluding Israel, have performed poorly compared to the rest of the world. For Egypt, although the ranking falls from 42 in 95-99 to 43 in 2000-04, the value of the index itself has increased from 5.44 to 5.98. This reflects a strong belief that Egypt will progress with economic reforms and liberalisation, and that steady growth will be achieved especially after the WTO and GATS.

Table 7.10: MENA Business Environment Rankings

	Overall ranking (out of 60 countries)		Value of the index (scores out of 10)	
	1995-99	2000-04	1995-99	2000-04
Israel	27	25	6.50	7.49
Turkey	37	41	5.54	6.06
Egypt	41	42	5.44	5.98
Saudi Arabia	42	45	5.39	5.92
Algeria	56	55	3.79	4.95
Iran	58	59	3.09	3.74
Iraq	60	60	1.82	2.04

Source: EIU, Country Forecasts (1999).

In Egypt, although there are some slight improvements in two factors: the infrastructure and institutions, these improvements could not offset the declines in the rest of the factors. For example, the sharp decline in the openness index was due to continued high tariffs and mismanagement whereas the weak government factor was due to high payroll and corporate tax rates. Technology, management and labour also contributed to the overall low ranking. It is clear the Egyptian government needs to improve a lot on its eight indicators to regain its high global ranking of 1995 (see table 7.11).

Table 7.11: MENA Countries Ranking in the Competitiveness Index (1995-1999)

Factor	1995	1996	1997	1998	1999
Openness	24	21	36	31	50
Government	15	30	15	25	31
Finance	29	36	34	30	39
Infrastructure	21	29	41	43	38
Technology	30	24	19	36	47
Management	29	23	21	42	52
Labour	34	40	39	36	57
Institutions	-	24	5	30	29
Overall ranking	27	29	28	38	49

Source: World Economic Forum (1999)

7.9 BUSINESS ENVIRONMENT IN EGYPT

Government in Egypt has a long history of being highly centralised. Nonetheless, considerable attention has been placed on decentralisation and devolution in recent years, much of it prompted by the international community, but much of it based on indigenous, strongly held views. Standard arguments used around the world in defence of devolution have been voiced, including the potential for enhanced efficiency, accountability, and local resource mobilisation and greater democratisation (Fox and Ghanim, 1998).

As a result and after decades of state domination of economic activity, many governments around the world are increasingly relying on the private sector to foster economic growth. Governments are becoming less engaged in the direct provision of goods and services, while becoming more active in developing market mechanisms, creating supporting institutions and providing safeguards to ensure equitable distribution.

While this broad observation is hard to dispute, the question arises as to what does it actually take to enhance the efficient participation of the private sector in economic growth? To this question, economists have now come to believe that private sector decisions depend on both the incentive structure reflecting the relative scarcity of resources as well as the incentive structure provided by prevailing institutional framework (Serven and Solimano 1993; Clague 1997). This broad definition of the incentive structure, which is supported by empirical evidence (Haque, 1995), is often referred to as the business environment. It encompasses two complementary preconditions appropriate and stable macroeconomic environment, on the one hand, and efficient institutions, on the other (Fawzy, 1998b).

This trend has begun in Egypt as well. In the early 1990s the Government of Egypt began implementing liberal policies to allow the private sector to lead economic growth. Privatisation is perceived as a cornerstone in the overall economic reform program. On the other hand, the policy and institutional environment has not improved fast enough. Privatisation has also been slow and private sector participation in infrastructure has been modest.

An increasing number of countries in the region, among them Morocco, Tunisia, Turkey, Jordan, Lebanon and Egypt have committed themselves to letting the private sector lead growth. In addition, to reforms on the macroeconomic front, these countries are making the business environment more friendly. They are reducing direct government involvement in the economy through privatisation, encouraging private sector participation in infrastructure and reforming their institutions to make them more hospitable to private investment. Progress has been uneven, however, and the business environment in these economies is generally less attractive than the East Asian, Latin America or Eastern Europe. Investors in the region claim that several obstacles continue to hinder the efficient operation of firms, exports and investment.

For example, the business environment of Egypt, Tunisia and Jordan show consistent patterns. On the positive side, producers and consumers in all three face more rational incentive structures in the 1990s than they did in the 1980s. On the negative side, the size and composition of the private sector remains modest and thin compared to the private sector in other developing countries. In Egypt, Tunisia and Jordan, the private sector still accounts for only 64 to 66% of GDP, compared with 80% in Brazil, 74% in Uruguay and 72% in Indonesia. The leading constraints on private sector operation and expansion are inefficient tax administration, a costly judicial system, and scarcity of skilled labour, elaborate collateral requirements to obtain finance and weak support systems.

Tax administration is often cited by the private sector as the biggest constraint to operation and expansion and by government officials as their biggest problem with the private sector. In Egypt, costs associated with tax administration for business are relatively high. Also, tax evasion in Egypt is widespread. Erratic methods of tax assessment are a serious business hazard, particularly for small firms. Investors complain that the criteria for tax assessment are ambiguous, that poorly trained collectors have arbitrary powers, and that the target incentives granted to them encourage exaggerated claims. Possible remedies for the weaknesses in the relationship between taxpayers and the tax authority include educating taxpayers, targeting voluntary compliance and streamlining tax collectors' incentives.

7.10 PRIVATE BUSINESS DEVELOPMENT IN EGYPT

The government earmarked 314 public sector enterprises for privatisation in 1991. These firms were stripped from their ministries and grouped under various holding companies within the Ministry of Public Enterprise pending privatisation. Since the beginning of transactions in 1994, more than 110 of the companies have been majority privatised and another 23 have been partially sold or leased. Transaction methods have included anchor investor sales, public offerings on the stock exchange, sales to Employee Shareholder Associations, asset liquidations and long term leases. So far, the program has brought in approximately LE 17 billion in revenues.

Officials have faced numerous challenges in executing the privatisation program, most of them related to consensus building. First the government had to assure workers that privatisation would not come at the expense of jobs. This was difficult, as most of the public sector firms are severely overstaffed. The primary strategy for addressing this problem has been early retirement. To date some 120.000 employees have been granted early retirement packages, funded by the proceeds of privatisation sales (see table 7.12).

Table 7.12: Number of Workers Retired (1998)

Holding company	Number of workers retired at June 30, 1998	Annual wages (LE Million)	Number of workers retired December 31, 1998	Annual wages saved (LE Million)
Textile manufacturing and trade	79.877	471.0	12.954	84.3
Cotton and international trade	37.944	247.0	10.243	53.9
Engineering industries	39.920	353.4	5.293	31.0
Metallurgical industries	59.756	660.8	2.879	31.9
Mining and refractories	41.635	448.5	3.222	23.3
Chemical industries	13.657	115.6	555	4.4
Pharmaceuticals and medical appliances	25.412	178.0	855	7.8
Food industry	63.216	406.0	3.302	10
Rice and flour mills	45.224	265.1	2.167	15.2
National construction	39.511	359.0	2.432	7.8
Electricity distribution	6.853	52	650	2.7
Housing, tourism and cinema	8.746	56.9	243	1.4
Maritime transport	21.919	222	3.602	27.3
Spinning and weaving	79.598	466.6	3.602	27.3
Agricultural development	12.722	46	429	2
Inland transport	30.168	227.1	1.208	2.9
Total	**606.158**	**4.575**	**53.385**	**326**

Source, Public Enterprise Office (PEO) (2000)

Second, the government had to combat the notion that privatisation only benefits wealthy people and foreign investors. This has required officials to adopt a careful approach to valuation, in order to avoid recriminations that companies are under-priced. Additionally, officials have taken care to ensure that public sector monopolies are not simply transformed into private sector monopolies. By moving slowly, the government has been able to accustom people to the idea of privatisation, highlight its benefits and progressively widen the scope of the program without generating a popular backlash. As a more practical matter, officials have faced the challenge of privatising many financially unattractive enterprises. In the past five years, however, restructuring efforts and debts settlement funded by privatisation proceeds have reduced the number of loss-making firms in the portfolio from 99 to 35.

The greatest danger of the slow pace is that it allows vested interests plenty of time to influence the direction of the process. Indeed, that many of the majority of privatised firms continue to function as they always have and under the same management. Nevertheless, the appointment of former privatisation chief Dr. Atef Abied as Prime Minister sends a clear signal that the program remains a priority. Furthermore, the new government's strategic use offering during its first year in office makes it quite apparent that privatisation is a question of when and not if.

Recent empirical evidence suggests that the role of the private sector in the Egyptian economy is expanding. But much remains to be done on the scope of the private sector in other emerging markets, and Egypt's goal of achieving a sustainable GDP growth rate around 7 to 8% annually (see table 7.13).

Table 7.13: Private Sector Indicators Egypt

	87/88	91/92	92/93	93/94	94/95	95/96	96/97	97/98
Private share in GDP %	62.4	61.2	61.8	61.7	62.6	63.3	66.4	66.8
Excluding agriculture %	54.0	53.8	54.4	54.4	55.6	56.6	60.4	61.3
Private share in implemented investment %	36.7	46.5	33.3	33.5	40.9	49.2	51.5	51.8
Private share in bank loans %	71.7	64.2	62.7	61.2	66.8	69.7	72.3	73.6
FDI US$ millions	1,125	1,152	1,139	1,320	782	626	769	..

Source: CBE, Annual Report (1997)

The private sector share in implemented investment also rose steadily from 46.5% to 51.8% through the same period; yet, a cross-country comparison suggests that these are rather low figures by the developing world's standards. In 1996, the share of private investment in Gross Domestic Investment amounted to an average of 73.8% in developing countries (see table 7.14).

Moreover, a World Bank study indicates that the recovery of private investment (after a drop in the two years following the stabilisation program), from 6.6% of Gross National Income (GNY) in 1992/93 to 9.4% of GNY in 1996/97, was not sufficient to reach its level of 15% on average before the reform program in 1989/90 or to compensate for the public investment contraction and induce a high GDP growth rate. The result was a moderate increase of gross domestic investment from 14.8% of GNY in 1992/93 to 16% of GNY. This is still low in comparison with the domestic investment level of 26.7% in 1989/90 in Egypt and of 25 to 30% in other emerging markets (World Bank 1997a).

As for foreign direct investment (FDI), the Egyptian economy experienced a decline in FDI flows by almost 50% between the years 1991/92 and 1996/97. The current FDI to GDP ratio of less than 1% is arguably lower than what is needed to bridge the investment/saving gap especially in the short run, and lower than its corresponding level of 3% in other developing countries in 1996 (see table 7.14).

Table 7.14: Private Sector Indicators: Cross-Country Comparison (1996) (%)

	Share of private investment in gross domestic fixed investment %	Share of FDI in GDP %	Share of government expenditure in GDP %
Egypt	59.1	0.9	28.4
Chile	80.0	5.5	16.8
Mexico	79.1	2.3	22.6
Thailand	77.6	1.3	18.0
Korea	76.0	0.5	24.8
Malaysia	69.8	4.5	35.1
Indonesia	60.5	3.5	16.6

Source: For the shares of government expenditure in GDP: World Economic Forum, The Global Competitiveness Report (1997); and for others: World Bank, World Development Indicators (1998e)

In short, it is clear that the increased private sector participation of the last three years is not sufficient to drive Egypt's growth. The relatively limited role of the private sector is also apparent considering the size of the government in the Egyptian economy. Although the size of government, measured by the share of government expenditure in GDP, has been reduced noticeably from 36% in 1993 to 28% in 1996, Table 7.14 indicates that it is still relatively high in Egypt compared to an average of 22% in other countries. Table 7.15 shows the cross-country privatisation record.

Table 7.15: Cross-Country Privatisation Record

(In billion of US dollars)

Country	years	Cumulative privatisation receipts US$ billion	Privatisation receipts per year (% of GDP)	
			Total	Per year
Hungary	1989-95	8.0	1.14	3.0
Poland	1990-95	3.0	0.50	0.6
Czech Republic	1993-95	2.3	0.77	1.9
Developing economies				
Mexico	1988-95	27.3	3.41	1.1
Argentina	1988-95	18.2	2.28	1.2
Chile	1973-91	3.4	0.38	1.2
Brazil	1989-95	9.7	1.39	0.3
Venezuela	1990-95	2.5	0.42	0.7
Philippines	1989-95	3.4	0.49	0.9
Malaysia	1988-95	9.2	1.15	2.1
Industrial economies				
United Kingdom	1979-95	96.7	6.04	0.8
France	1985-95	34.1	3.41	0.3
Italy	1985-95	17.0	1.70	0.2
New Zealand	1985-95	9.0	0.90	2.2
Spain	1989-95	8.3	0.83	0.2
Canada	1989-95	7.6	0.76	0.2
Portugal	1985-95	5.3	0.53	0.8
Egypt	**1994-2000**	**4.44**	**0.5**	**0.94**

Source, World Bank (2000b)

7.10.1 COMPOSITION OF THE PRIVATE BUSINESS

In terms of sectoral distribution, private investment has grown at different rates across economic activities, which explains the change in its composition in 1997/98 compared to 1991/92. As shown in Table 7.16, the productive services sector witnessed the highest growth rate in private investment. The result was an increase in the productive services share of private investment at the expense of both the commodity and social services sectors. Private firms are *increasingly turning* away from the commodity sector to transportation, communications and tourism.

While the commodity sector's share in private investment decreased, within this group, the relative importance of the agriculture and manufacturing sectors increased. The two sectors that registered a decline in their share of private investment are the petroleum sector and the social services sector. Despite the decline of private investment in the petroleum sector, manufacturing and petroleum continue to be the leading sectors that have consistently attracted more than 40% of private investment, followed by tourism and agriculture (see table 7.16).

Table 7.16: Distribution of Private Investment Between Economic Sectors (%)

	Share in Total Private Investment %	
	1991/92	1997/98
Commodity Sector	**58.9**	**55.9**
Agriculture	7.7	10.1
Industry and mining	23.6	27.5
Petroleum and its products	25.5	14.9
Electricity	0.0	0.6
Construction	2.1	2.8
Productive Services	**14.5**	**22.1**
Transportation & Suez Canal	4.3	7.4
Trade, banking and insurance	3.3	3.5
Hotels and restaurants	6.9	11.2
Social Services	**26.6**	**22.0**
Total	**100.0**	**100.0**

Source: Calculated from: CBE, Economic Review, different issues; and CBE, Annual Report, different issues.

The share of the private sector in GDP by economic sector is illustrated in Table 7.17 which shows that the private sector generates most value added in all activities, with the exception of petroleum, money and banking, and insurance. The share of private sector in GDP in all economic activities has increased over the period 1991/92 to 1996/97, again with the exception of petroleum. Tables 7.16 and 7.17 indicate that the private sector's largest rate of growth in both investment and GDP took place in the manufacturing sector. This trend may be attributed to the increased private investment in new industrial cities. To date, 12 new industrial cities have been developed with 2,000 productive factories, the majority of which are private firms (Ministry of Economy, Egypt, 1999).

Table 7.17: Share of Private Sector in GDP by Economic Activity (%)*

	1985/86	1991/92	1997/98
Commodity Sector	**62.8**	**62.8**	**68.8**
Agriculture	98.3	98.8	98.7
Industry and mining	44.7	58.1	74.0
Petroleum and its products	21.3	17.3	13.3
Electricity	0.0	0.0	0.0
Construction	65.1	70.8	73.8
Productive Services	**59.3**	**62.1**	**68.6**
Transportation	40.6	47.9	55.8
Suez Canal	0.0	0.0	0.0
Trade	81.2	89.7	94.4
Money and banking	22.9	29.3	30.4
Insurance	20.0	39.5	41.2
Hotels and restaurants	80.2	84.7	85.3
Social Services	**50.3**	**54.9**	**55.3**
Total GDP	**59.1**	**61.2**	**66.4**
Total GDP excluding agriculture	**50.2**	**53.8**	**60.4.**

*GDP at factor cost

Source: CBE, Annual Report, different issues.

As for the composition of the private investment among tradables and non-tradables, a recent study (Ministry of Planning Egypt, 2000) indicates that private investment has been increasingly concentrated in the non-tradables sector. Several factors help explain this pattern, including the shift in relative prices of tradables and non-tradables in favour of non-tradables; the high export transaction costs which make it more profitable to sell in the domestic market than to export; and finally, the fact that most private investments are small and micro-size firms, and do not enjoy any economies of scale, thus hampering any possibility for exporting (World Bank, 1997a).

Besides this change in the composition of the private sector, 1999 brought a significant diversification in its activities. For the first time in Egypt, the private sector has got involved in developing infrastructure. The government announced that all future power generation projects would be constructed on a build-own-operate-transfer (BOOT) basis. The private sector started to invest in infrastructure with three bids for BOOT projects in airports and two new BOOT projects planned to develop in roads. In addition, cellular phone concessions have been sold to private firms and ports and port services have been opened to private investors (The American Chamber of Commerce in Egypt, 1999).

7.10.2 CHARACTERISTICS OF PRIVATE INVESTMENT IN EGYPT

The Egyptian private sector includes a wide range of economic participants with respect to their size, legal form, and formal registration. Three salient features characterise the private sector and are likely to influence its power to drive the economy on the growth trajectory:

- The dominance of small and micro firms;
- The prevalence of the partnership legal form;
- The presence of a large informal sector.

The private sector structure in Egypt has a dual nature in terms of size: at one end, there are a large number of small and micro firms, but there is a limited number of large-size firms. Small and micro enterprises represent nearly 98% of private economic units; they create nearly three-quarters of all private jobs and produce an estimated 80% of the country's private value added (Guigale and Mobarak 1996). If we exclude the agriculture sector, the figures will of course decline; however, the magnitude of small and micro-size firms will still be significant. Despite their dominance, small and micro-size firms are not participating efficiently in Egypt's growth.

- First, small firms suffer more than large firms from institutional constraints;
- Second, they serve mainly low-income consumers with low quality, low price products;
- Third, most of these firms use obsolete technologies. Conversely, while large-size firms are relatively well developed, there are too few to foster large private sector growth.

As for the legal status of private firms, in 1992, most private establishments in non-agricultural activities were incorporated either in the form of individual proprietorships (47%) or partnerships (48%), while private joint stock firms represented only 4.4% of all private firms (World Bank, 1998d). The implication of this is that the partnership form dominates, and more than 90% of private firms are run on a family, rather than a corporate, basis. In addition, most private firms do not trade on the stock market, and although some have been listed recently, this is done for tax reasons and not to enlarge the shareholders' base.

Another important characteristic of the Egyptian private investment is the large informal sector (30-50%). Despite the unavailability of accurate figures on the size of the informal sector in Egypt, different studies provide approximate estimations indicating that the majority of small and micro enterprises are informal. For example, in 1991, informal enterprises were estimated to reach 2.28 millions (The Alexandria Businessmen's Association, 1996). EFG-Hermes estimates the informal sector today to be nearly 40% of the total economy (EFG-Hermes, 2000). In 1997a, The World Bank estimated informal urban and rural real estate at US$ 240 billion, which represents 64% of total assets accumulated in Egyptian real estate. The legacy of socialist policies, cumbersome regulatory regimes and high transaction costs explain the large share of the informal private sector. The implication is that informal assets cannot be used either in efficient and legally secured market transactions or as collateral. In addition, the higher the share of the informal sector, the less confidence and certainty for private investment (World Bank, 1999d).

Based on this analysis, it is evident that despite some positive signs of development, the Egyptian private sector is not yet able to act as a catalyst for growth at present. The moderate growth rate of private investment, the decline of foreign direct investment inflows, the dominance of weak and underdeveloped small and micro enterprises, the large informal sector, the family-based management strategies and the inward orientation of the majority of private firms all reflect a shallow state of development.

Investors claim that the business environment is responsible for their unsatisfactory performance. More importantly, they argue that despite the ongoing reforms, still two major problems in the business environment impede their growth and efficiency:

- A distorted macroeconomic incentive structure;
- Cumbersome institutional constraints.

The former results in a weak incentive to invest and the latter in high transaction costs resulting in a lack of competitiveness.

7.11 SUMMARY

This chapter discussed the political, economic, and social structure of Egypt. It showed that Egypt's economy is small, yet relatively well diversified for what the World Bank categories as a 'lower middle income' country. Egypt's economic stabilisation programme, initiated in 1990/91, has produced significant results in most macroeconomic areas. The country's capital markets have been dynamised, and flows of foreign direct investment are substantial and growing. Egypt has also joined various free trade agreements and moved towards liberalisation of its economic activities.

Half the foreign direct investment is in manufacturing and 30% in banking. As a result of these flows and trade reforms, real Gross Domestic Product GDP grew by 5.1% in 1996 and by 5.9% in 1997.

Chapter 8 will examine Egypt's trade policy options towards liberalisation.