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A Pivot to a Services Trade Agenda Can Help Economic Growth

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The coronavirus pandemic has restricted people's physical movement but not the exchange of information, knowledge, and other digitally delivered services. The post-coronavirus future will likely continue to include an ever-expanding range of associated business, professional, and technical services that firms and workers deliver digitally. Policymakers need to expand their focus beyond goods trade to include a trade agenda that embraces US services in the world economy.

Growth in trade in services and digital connections has outpaced merchandise trade for the past 25 years, as advances in information communications technology and digitalization have enabled more services to be delivered remotely over long distances. The pandemic is likely to reinforce this trend. Better measurement tools and rules for services trade can assist this key driver of domestic and global economic growth in a world that increasingly relies on digital connections.

SERVICES DRIVE ECONOMIC GROWTH

From telecommunications, information and data analytics, and finance to health and education, the diverse and far-reaching services sector contributes a larger share of GDP in the US and world economies than goods or agriculture. For advanced economies such as the United States, Jack Triplett and Barry Bosworth show that the service sectors have been the accelerating factors behind US productivity growth, although the channels through which productivity improvements are realized vary across sectors.[1] For instance, deregulation in services was the key factor driving growth through reorganization in railroads and trucking; the rapid adoption of new information and communications technologies was the driving factor for growth in communications and finance; and advances in information technologies such as scanners and computers were key for

productivity improvements in retailing. Unsurprisingly, the bigger payoff for the United States and other advanced economies comes from opening up services trade rather than further liberalizing goods trade.[2]

Developing countries stand to gain as well. Services crossing borders carry with them new information and advanced technology, which spills over to other sectors.[3] Empirical evidence for particular countries and sectors where data are available supports this notion, showing the benefits for other sectors of the economy and for manufacturing in particular.[4]

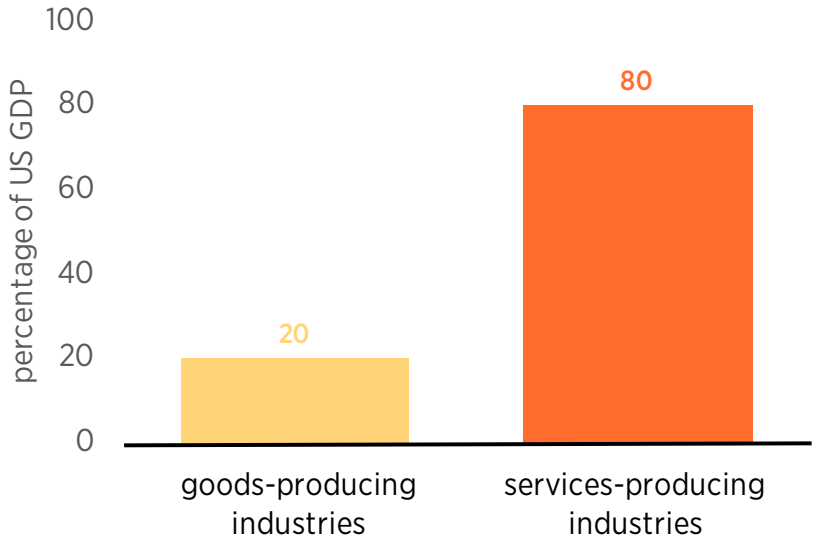
A LARGE PART OF THE ECONOMY, YET INVISIBLE IN THE TRADE DATA

Service-producing industries account for a large majority of US economic activity and employment, as shown in figures 1 and 2. These industries account for 80 percent of value added in US GDP (the latest data available are from Q3 2019);[5] for 65 percent of value added in world GDP (the latest data available are from 2018);[6] and for 80.2 percent of US employment (the latest data available are from 2018).[7] For many sectors that provide services, exports are a main source of revenue. But when service-providing businesses export, those trade flows are often invisible in traditional data.

Trade flows in goods, such as manufactured merchandise, agriculture, and energy, are easy to see and measure. When an automaker makes a sale to Canada, or a soybean farmer makes a sale to China, or a liquid natural gas producer makes a sale to Spain, the volume and value of those goods in the shipping container are measured and recorded, and the figures show up in the monthly trade statistics. Advocates can easily point to their industry export figures as contributors to GDP, and policymakers in an export-centric world prioritize accordingly.

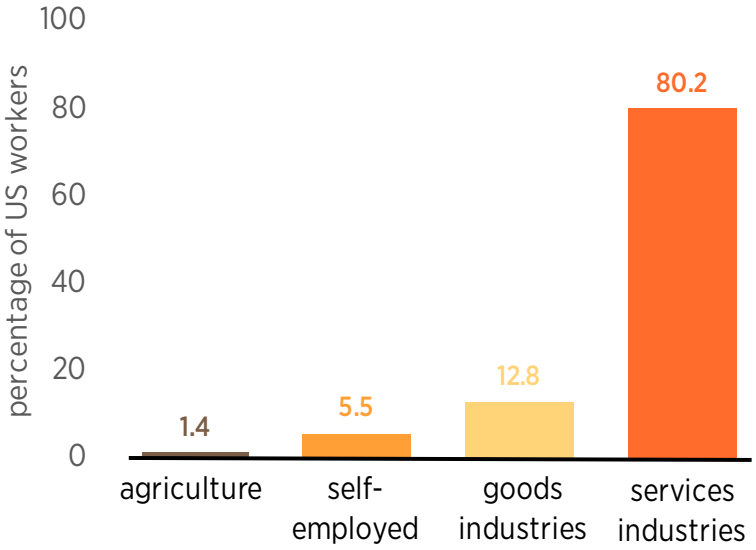
But exports for the service-providing industries are not measured in the same way, and they do not show up in regularly cited monthly trade numbers. There is no container of services that crosses a border. Instead, services are often sold to subsidiaries or affiliates abroad, or they come in the form of revenues from a licensing or royalty agreement, often with a third party. In 2002, Bureau of Economic Analysis (BEA) economists Obie G. Whichard and Maria Borga discussed at length key measurement issues by sector, tracing international services transactions through the global economy and demonstrating why they do not show up in traditional trade data. The authors suggested measures that weigh the need for theoretically correct measures against the practical difficulties in developing such measures.[8] Most of those challenges remain, although a number of BEA working papers highlight new developments and digital trends in international services transactions.[9]

Figure 1. Services Comprise 80 Percent of the US Economy



Source: Federal Reserve Bank of St. Louis, "Value Added by Industry as a Percentage of Gross Domestic Product, Q3 2019," accessed April 1, 2020, https://fred.stlouisfed.org/release/tables?rid=331&eid=211.

Figure 2. Service Industries Employ More Than 80 Percent of US Workers



Notes: "Agriculture" includes agriculture, forestry, fishing, and hunting. "Self-employed" means self-employed excluding agriculture. "Goods industries" are goods-producing industries excluding agriculture. "Services industries" are services-producing industries excluding agriculture. Numbers do not add to 100 percent owing to rounding.
Source: Bureau of Labor Statistics, "Table 2.1 Employment by Major Industry Sector," accessed April 1, 2020, https://www.bls.gov/emp/tables/employment-by-major-industry-sector.htm.

A large part of the sales in the US high-tech sector is essentially for services. Consider a US multinational semiconductor and telecommunications equipment company. It designs and markets wireless telecommunications products and services. Some of its revenues are from selling tangible items like computer chips, but a significant share of its revenues and profits are derived from patent licensing businesses. Similarly, US firms that provide data and analytics services (large multinationals like Microsoft as well as more than 800,000 small and medium-sized businesses across the country) derive their revenue from cloud services sales;[10] those sales do not represent units that travel in a container, nor do they show up in traditional trade data. The entertainment production industry is another example of intangible products and services that are sold across borders but not in a container. From the 1,800 film production startups listed on AngelList to Netflix, HBO, and the motion picture industry, there are 2.4 million Americans that work every day to create and produce content.[11] When they sell their content to foreigners (that is, when they export), those sales are usually part of copyright or licensing agreements, yet the revenues from those agreements (their export sales) do not appear in traditional trade statistics.

SERVICES LIBERALIZATION CAN ENABLE MUCH-NEEDED INNOVATIONS IN THE NEAR FUTURE

Services liberalization could enable innovations and increased trade in a number of areas. One example is in education and e-learning platforms, which will be urgently needed given the current travel restrictions, many of which may remain in effect for some time. Streaming services can enable content creators and the entertainment sector to stay afloat and even thrive in an age of travel restrictions.

Another example is the healthcare sector. My colleague Robert Graboyes has explored how delivery system innovations in healthcare could reduce costs and improve access, especially during emergencies.[12]

Over the past few years, technology has transformed some sectors, such as transportation and hotels, that were once thought to be place-based (e.g., internet-based business models such as Uber and Airbnb). Internet-based business models demonstrate that services can go global to an extent and at a speed not seen before even by some of the largest multinational manufacturers and franchises. Market access and rules that support the free flow of information can enable businesses and consumers around the world to connect in areas that were previously not possible.

KEY RESTRICTIONS AND HOW TO GET AROUND THEM

US businesses that provide services often face more restrictions on cross-border sales than those that provide goods. Many countries outlaw sales of services by foreign firms outright, and sometimes they require a local presence. Some countries require that data about a nation's citizens or

residents be collected, processed, and stored inside the country. Some countries exercising these data localization rules cite concerns over data privacy, but legitimate arguments have been made that such laws do nothing to protect data or privacy and in fact may have the opposite effect. The US Trade Representative duly notes key barriers to digital trade, including those that "block the flow of data across borders, impede the provision of services such as cloud computing, or otherwise restrict the ability of firms to take advantage of best-in-class digital services. Some of these government actions are explicitly protectionist, while others impose unnecessary burdens on digital trade in seeking to address legitimate public policy goals."[13] All of these restrictions result in lower levels of services trade, and hence end- users of services (consumers and businesses) ultimately have fewer services available, lower-quality services, and higher markups, all of which impede economic growth.

The digital and e-commerce trade chapters in the United States–Mexico–Canada Agreement (USMCA) are bright spots in US trade policy that inhibit unnecessary restrictions while allowing countries to pursue their public policy objectives in the least trade-restricting manner.[14] These rules should be applied to trade with the European Union and all major US trading partners.

SERVICES LIBERALIZATION PROGRESS TO DATE

A robust services trade agenda includes provisions on intellectual property rights instruments, such as patent licensing agreements and robust, well-crafted copyright and trademark regimes that are supported and enforced by domestic and international rules and laws. Current access to global markets for merchandise trade is the result of persistent efforts, since the end of World War II, to reduce not just tariffs but nontariff and behind-the-border barriers. If access to global markets for services trade is to follow the same path, then continuous adaptation of provisions that facilitate services trade, such as intellectual property rights instruments, must follow.

Unlike trade in goods, progress in liberalization of services trade rules has been achieved in bilateral and targeted regional deals rather than multilateral agreements. The Korea–US Free Trade Agreement and the USMCA are bright spots. The last multilateral trade negotiation to date was the Doha Round, which did include services (albeit on a small scale), but in the end countries could not overcome their disagreements about agriculture market access. The World Trade Organization continues to work on services trade liberalization with its Trade in Services Agreement, although progress has been slow.

WHAT POLICYMAKERS CAN DO NOW

Given the potential need for greater access to services markets and the unique challenges the US and global economies face in the near term, the following policy actions could help prevent a dramatic and devastating drop in international commerce.

1. Pivot Away from Tariffs and Toward Services Trade Liberalization with Key Partners

The export-centric trade policy climate has hindered progress in services trade liberalization. The focus on agriculture, steel, and autos has swallowed up much political capital in the international trade policy space and has overshadowed efforts to move forward with key trading partners. Policymakers should pivot away from more tariffs on goods. Instead, they should focus on services while working with key US economic partners in the European Union, South America, Latin America, and Asia. The e-commerce and digital trade chapters in the USMCA would be a good template from which to begin.

2. Offer Caveats When Using State and Congressional District Trade Data

When using international trade data, analysts, aides, staffers, and policymakers should offer caveats for any interpretation of the data with the recognition that the data are only capturing a portion of international trade, and specifically that the data do not wholly capture international services transactions. Trade policy analysis based on data must recognize that traditional trade statistics are missing the bulk of the US services sector.

Further, efforts at agencies such as the US International Trade Commission and US Department of Commerce to disaggregate trade data at the state and even congressional district level are commendable to the extent that they will enable policymakers to see detailed data about their communities. But analysts should recognize that the data are giving policymakers a false sense of precision because policymakers are simply getting a closer look at an incomplete picture. While state and congressional district trade data can pinpoint the source of soybean exports or even assembled automobiles, they still miss most services trade and the activities of 80 percent of the labor force.

3. Ask the BEA to Expertly Combine Data Series to Paint a Bigger Picture

Policymakers should ask statistical agencies such as the BEA to produce a data series that expertly combines cross-border exports and sales by affiliates abroad. For instance, the BEA could start to produce a series on foreign sales of US services defined broadly to capture the relevant sales by foreign affiliates and subsidiaries.

CONCLUDING REMARKS

The COVID-19 pandemic illustrates the relative importance of digital connections. As the Dow Jones Industrial Average has been dropping over recent weeks, the stock price of Zoom Video Communications recently just reached its all-time high.[15]

The US and global economies will emerge from the pandemic with an appetite for capital. Policymakers must be committed to services liberalization for stronger economic growth. They must

look beyond the traditional monthly trade statistics because those data do not tell even half of the story. Getting services to power economic growth will do far more than any tariffs could do for the sectors that have consumed US political capital in trade lately, such as steel, agriculture, and autos. The economic benefits for the US and world economies from seeing services providers of all sizes being able to compete unfettered around the world are too large to forgo.

ABOUT THE AUTHOR

Christine McDaniel is a senior research fellow at the Mercatus Center at George Mason University. Her research focuses on international trade, globalization, and intellectual property rights. McDaniel previously worked at Sidley Austin, LLP, a global law firm, where she was a senior economist. She has held several positions in the US government, including deputy assistant secretary at the Treasury Department and senior trade economist in the White House Council of Economic Advisers, and she has worked in the economic offices of the US Department of Commerce, US Trade Representative, and US International Trade Commission.

NOTES

1. Jack E. Triplett and Barry P. Bosworth, *Productivity in the U.S. Services Sector: New Sources of Economic Growth* (Washington, DC: Brookings Institution Press, 2016).
2. The 2006 *Economic Report of the President* (Washington, DC: US Government Printing Office, 2006) highlighted the outsized role of services in economic output and employment and their critical input for the production of other goods and services. The 2007 *Economic Report of the President* (Washington, DC: US Government Printing Office, 2007) explained the vast economic benefits from trade liberalization for services and noted the US competitive advantage in services.
3. Sherman Robinson, Zhi Wang, and Will Martin, "Capturing the Implications of Services Trade Liberalization," *Economic System Research* 14, no. 2 (2002). Note that reducing or eliminating agricultural trade barriers and subsidies in developed countries remains a point of contention in multilateral trade discussions.
4. Beata Smarzynska Javorcik, Wolfgang Keller, and James R. Tybout, "Openness and Industrial Responses in a Wal-Mart World: A Case Study of Mexican Soaps, Detergents and Surfactant Producers" (NBER Working Paper No. 12457, National Bureau of Economic Research, Cambridge, MA, August 2006); Beata Javorcik and Yue Li, "Do the Biggest Aisles Serve a Brighter Future? Global Retail Chains and Their Implications for Romania," *Journal of International Economics* 90, no. 2 (July 2013); Jens Arnold, Beata Javorcik, and Aaditya Mattoo, "Does Services Liberalization Benefit Manufacturing Firms? Evidence from the Czech Republic," *Journal of International Economics* 85, no. 1 (September 2011).
5. Federal Reserve Bank of St. Louis, "Value Added by Industry as a Percentage of Gross Domestic Product, Q3 2019," accessed April 1, 2020, https://fred.stlouisfed.org/release/tables?rid=331&eid=211.
6. World Bank, "World Development Indicators: Structure of Output," accessed April 1, 2020, http://wdi.worldbank.org/table/4.2.
7. Bureau of Labor Statistics, "Table 2.1 Employment by Major Industry Sector," accessed April 1, 2020, https://www.bls.gov/emp/tables/employment-by-major-industry-sector.htm.
8. Obie G. Whichard and Maria Borga, "Selected Issues in the Measurement of U.S. International Services" (working paper, Bureau of Economic Analysis, Washington, DC, June 2002).

9. For instance, see Maria Borga and Jennifer Koncz-Bruner, "Trends in Digitally-Enabled Trade in Services" (working paper, Bureau of Economic Analysis, Washington, DC, September 2012); Marilyn Ibarra-Caton and Raymond J. Mataloni Jr., "Headquarter Services in the Global Integration of Production" (working paper, Bureau of Economic Analysis, Washington, DC, October 2015); Michael Mann, "Measuring Trade in Services by Mode of Supply" (working paper, Bureau of Economic Analysis, Washington, DC, August 2019); and James J. Fetzer, Raymond J. Mataloni Jr., and Sarahelen Thompson, "BEA's Initiative to Expand and Reconcile Trade in Services Statistics: New Detail for Improved Analysis" (GTAP Resource No. 5235, Global Trade Analysis Project, West Lafayette, IN, 2017).

10. Data from the 2017 Statistics of US Businesses show 1.9 million firms with fewer than 500 employees in the following sectors: information; finance and real estate; professional, scientific, and technical services; management of companies and enterprises; educational services; and health services. Census Bureau, "2017 SUSB Annual Data Tables by Establishment Industry," March 9, 2020, https://www.census.gov/data/tables/2017/econ/susb/2017-susb-annual.html.

11. Bureau of Labor Statistics, Occupation Employment Statistics, "May 2018 National Industry-Specific Occupational Employment and Wage Estimates, Sector 71 - Arts, Entertainment, and Recreation," accessed April 1, 2020, https://www.bls.gov/oes/2018/may/naics2_71.htm#00-0000.

12. Robert F. Graboyes, "Delivery System Innovation Is the Key to Better Healthcare" (Testimony before the House Committee on Ways and Means, Rural and Underserved Communities Health Task Force, Mercatus Center at George Mason University, November 29, 2019).

13. Office of the United States Trade Representative, "2018 Fact Sheet: Key Barriers to Digital Trade," accessed April 1, 2020, https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2018/march/2018-fact-sheet-key-barriers-digital.

14. Office of the United States Trade Representative, "Agreement between the United States of America, the United Mexican States, and Canada 12/13/19 Text," accesed April 1, 2020, https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between.

15. On March 23, 2020, the stock price of Zoom Video Communications on NASDAQ reached $159.56 per share, an all-time high for the company. See NASDAQ, "ZM," accessed March 23, 2020, https://www.nasdaq.com/market-activity/stocks/zm.