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US-China Tariff War Masks Ascendency of Trade in Services

Growth of Global Trade in Goods Dwarfed by Cross-Border Services Transactions

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With the daily headlines about the U.S. and China imposing tariffs on merchandise in each other's markets, you might get the impression that all that matters in international commerce today is the exchange of goods between countries, such as raw or refined commodities, textiles and clothing, steel products, and other manufactured items. However, you would be dead wrong.

A large portion of cross-border transactions in the modern economy is in the services sectors, a swath of diverse activities, including transport, banking, tourism, telecommunications, e-commerce, management consulting, education, accounting, and informatics. In fact, w*orldwide* growth in services trade has significantly outpaced that of products. In 1975, total global merchandise trade (both exports and imports) accounted for 27% of the world's GDP. At that time, the share of global GDP represented by total services trade was only 6%. However, by 2018, services trade as a percentage of the world's GDP had more than doubled, whereas trade in goods as a share global GDP increased by only 70%.

To be sure, the current White House's obsession with merchandise trade is most pronounced in the case of U.S.-China economic relations. Washington's current trade war with Beijing is predicated on the bilateral deficit in the two countries' trade in *goods*. That deficit totaled $419.2 billion in 2018. This is why U.S. President Donald Trump's trade weapon of choice with the Chinese is the imposition of tariffs on U.S. imports of goods from China. If Trump could eliminate the bilateral deficit in merchandise trade with China by applying higher and higher tariffs--or perhaps more simply if Xi Jinping would just write him a check for $419.2 billion--Trump would declare victory.

That objective is wrongheaded for two reasons.

First, Mr. Trump ignores the fact that the Chinese in 2018 bought $41.5 billion more *services* from Americans than the U.S. bought from China. That is, the U.S. is actually running a *surplus* in services trade with China. This surplus means the *overall* U.S. bilateral trade deficit with China is actually lower than what Trump thinks. It is $377.7 billion.

Second, bilateral trade deficits in and of themselves are not economically meaningful. To this end, the problems with China's trade practices are far more fundamental: it is that they are not consistent with Beijing's legal market reform commitments made in 2001 with China's accession to the WTO, including ending subsidies to state-owned enterprises; protecting intellectual property; and transparently and consistently applying administrative procedures and laws; among other items. No matter how high the tariffs, they will not induce these structural reforms.

Many people, with Mr. Trump at the head of the pack, do not seem to understand that growth of international trade in services runs in parallel with the prosperity of nations, epitomized by the wealthiest countries—the members of the OECD. The two largest OECD participants in services trade with the rest of the world are the U.S., whose global trade in services totaled US$ 1.3 trillion in 2016, and Germany, where the corresponding number was US$ 607 billion, less than half the magnitude of the U.S. Mr. Trump will no doubt be surprised to learn that while the U.S.'s balance of global trade in services is in surplus by US$ 247 billion, Germany's global services trade balance is in deficit of US$ 23 billion.

The notion that there actually can be cross-border trade in the provision of services was, at one time, surely a seemingly abstract concept. I know this firsthand from the 1990s, when I served as the lead U.S. trade negotiator in charge of developing today's system of multilateral rules governing such transactions. Those rules are embodied in the General Agreement on Trade in Services (GATS), which was established part and parcel of the World Trade Organization (WTO) at the latter's inception.

While the importance of services trade to U.S. competitiveness may have once been out of the mainstream of trade policy thinking, that was decades ago. If Trump's economic advisors are worth their salt, they should know better. If they do, then why can't they get through to the boss?

Perhaps Trump's distorted view towards the importance of international trade in services stems from sheer ignorance. That is hard to believe. After all, he did attend the Wharton School of Business at the University of Pennsylvania, from which he graduated in 1968 with a Bachelor's Degree in Economics. Such training, one would assume, equipped him with the tools to understand the concept of cross-border services transactions, even if they were not as commonplace then as they are today.

Alternatively, does it stem from a nostalgic hope to return to years gone by when manufactured merchandise and other goods dominated economic activity in the U.S. and elsewhere? If so, he would do well to recognize that such a wish is far-fetched. Why? Because over the last 20 years, in *every country of the world—rich as well as poor—* manufacturing's contribution to GDP actually has been *declining* while the share of GDP accounted for by services has been *rising.*

It's ironic that not only is the core of the Trump Organization in the real estate industry, a prime component of the services sector, but Mr. Trump's course concentration in economics at Wharton was in real estate. Even television, Trump's second occupation, is a services industry.

Despite this, Trump might well believe that a shift to a services-oriented economy is a sign of economic decline. If so, the latest data, which are for 2015, suggest he would be quite mistaken. In high-income countries, services' share of GDP has risen to 75%. In low- and middle-income states, the share of GDP accounted for by services has increased to 56%.

Whatever the reason for Trump's myopia toward the fastest growing portion of international trade, he needs to realize that he—like the rest of us—is not living in an economy of years gone by.

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