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International Trade in Services

International trade in *services* refers to a wide and growing range of economic activities. These activities include transport, tourism, financial services, use of intellectual property, telecommunications and information services, government services, maintenance, and other professional services from accounting to legal services. As services account for over 80% of U.S. employment and 79% of U.S. gross domestic product (GDP), trade in services, both as exports and as inputs to other exported products, can have a broad impact across the U.S. economy. The United States is the world's leading services exporter and importer. The United States continues to negotiate trade agreements both bilaterally and multilaterally in the World Trade Organization (WTO) to lower *behind the border* barriers that limit U.S. services exports.

Role of Services in the Economy

Rapid advances in information and communications technology (ICT) and the related growth of global value chains (GVCs) are making an expanding range of services tradable across national borders. Many services require direct contact between the supplier and consumer and, therefore, service providers often need to establish a presence in the country of the consumer through foreign direct investment (FDI). To account for the variety in how services are traded, WTO members defined a system for classifying four modes of delivery for services based on the location of the service supplier and the consumer, taking into account their respective nationalities:

- Mode 1: Cross-border Supply (consumer and service supplier located in their respective countries)
- Mode 2: Consumption Abroad (consumer travels)
- Mode 3: Commercial Presence in another country (FDI)
- Mode 4: Temporary Presence (service supplier travels)

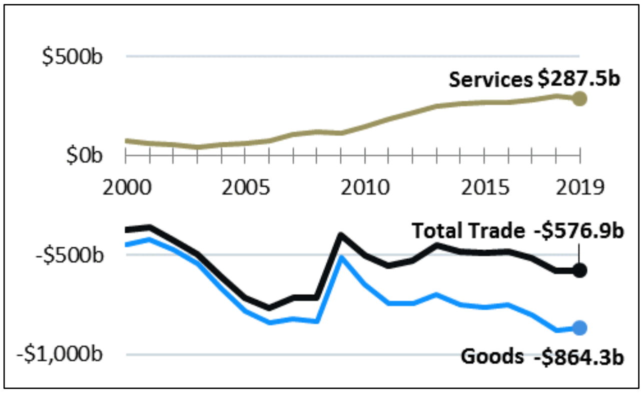
Measurements of trade in services are captured in two types of data: cross-border trade (sold via Modes 1, 2, and 4) and services sold by a local affiliate of a foreign company to a consumer of the local economy (Mode 3). The United States has continually realized surpluses in cross-border services trade, which have partially offset large deficits in goods trade (**Figure 1**). U.S. foreign affiliate trade generates greater revenue than cross-border trade and most of the revenue is from Europe (see **Figure 2**).

Digital Economy and Services Trade

Cross-border services are often provided online or on the telephone. These services are considered ICT-enabled or potentially ICT-enabled (PICTE) services, and include an array of services, such as insurance and financial services; customer service; and business services like research, consulting, and engineering. ICT-enabled and PICTE services accounted for 69% of U.S. cross-border services exports in 2019.

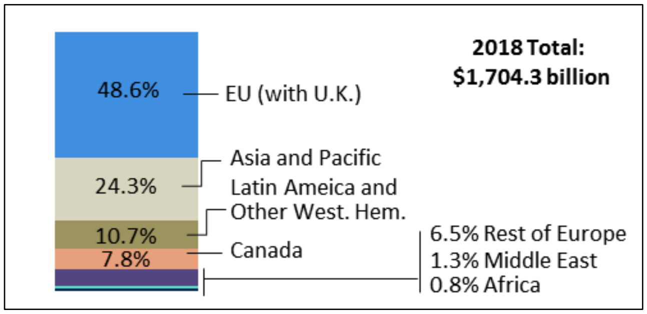
GVCs divide production processes into discrete stages located around the world and their growth has heightened the interdependence and interconnectedness of the global economy. These networks have also expanded and redefined the role that services play in international trade. Traditional data may understate the role of U.S. services because trade statistics measure goods based on the value of the final product, and not on a value-added basis. Therefore, conventional data does not attribute any portion of the traded value of manufactured and agricultural products to services inputs, such as research and development, design, transportation costs, and finance.

Figure 1. U.S. Net Trade, 2000-2019



Source: CRS, based on data from U.S. Department of Commerce, Bureau of Economic Analysis.

Figure 2. U.S. Services Supplied Through Majority-Owned Foreign Affiliates, 2018



Source: CRS, based on data from U.S. Department of Commerce, Bureau of Economic Analysis.

Impact of COVID-19 Pandemic

When the novel coronavirus (COVID-19) pandemic hit, the top U.S. cross-border services export, travel, declined sharply as countries implemented lockdowns and other restrictions. The WTO noted that global trade in services plunged by a record 30% in Q2 2020 across all regions, with tourism, transport, and distribution impacted the most. In contrast, online retail, health, education, audio-visual services, and telecommunications saw gains as consumers stayed home. U.S. services imports and exports declined 21% year-over-year for Q1-3 2020.

Barriers to Trade in Services

As in trade in goods, foreign government barriers prevent U.S. trade in services from expanding to its full potential. Unlike trade in goods, however, these barriers are often *behind the border*, rather than in the form of tariffs or custom regulations. In many cases, the impediments are government regulations or rules that appear legitimate but may intentionally or unintentionally discriminate against foreign providers (see **text box**).

Examples of Service Trade Barriers

- restrictions on international payments
- requirements that foreign professionals have local certification, training, and/or licensing
- localization restrictions (e.g., local content requirements, data flow limitations)
- government-owned monopoly service providers
- restrictions on FDI or movement of personnel

The 2019 OECD Services Trade Restrictiveness Index shows that the U.S. business environment is relatively open and competitive for services, compared to the 45 other countries studied. Apart from a few sectors, such as air travel, foreign providers are allowed to compete equally and have access in the United States.

WTO and General Agreement on Trade in Services (GATS)

The GATS, concluded in 1994, is the only multilateral framework of principles and rules for government policies and regulations affecting trade in services. The GATS contains commitments that apply to all services, including nondiscriminatory treatment of foreign service providers, transparency, and other regulatory obligations such as impartiality and reasonableness.

Other commitments for national treatment vary by WTO member as they apply only to those service sectors and modes of delivery listed in each member's schedule (so-called *positive list* of commitments). For these sectors, the GATS addresses market access barriers in the form of restrictions on: the number of foreign service suppliers, total value of service transactions or assets, number of transactions or value of output, type of legal entity or joint venture through which services may be supplied, and share of foreign capital in terms of ownership or total value of FDI. In addition to the GATS, 56 members concluded negotiations on financial services, and 108 members agreed to commitments on telecommunications services. The United States is a party to both agreements.

A subset of WTO members, 63 parties representing 73% of world services trade, are currently negotiating on domestic regulation of services. The negotiations aim to develop disciplines to mitigate barriers related to licensing and qualification requirements and procedures, and technical standards. The United States is not involved in these talks, but has engaged in the stalled multilateral discussions to update the GATS and further liberalize services trade.

U.S. Free Trade Agreements (FTAs)

In addition to multilateral trade liberalization and rules-setting efforts in the WTO, the United States works with trading partners to develop and implement rules to reduce barriers and facilitate trade in services without infringing on the sovereign rights of governments to regulate services for prudential, sound regulatory, or essential security reasons. The United States has also sought to go beyond the GATS (WTO-plus) under more comprehensive rules in U.S. free trade agreements (FTAs). Unlike GATS, each U.S. FTA uses a *negative list* for market access and national treatment coverage and commitments so that the provisions apply to all categories of services in all modes of delivery, unless a party to the agreement has taken a specific exception.

The 2015 Trade Promotion Authority (TPA) legislation contained specific trade negotiating objectives on services trade, digital trade in goods and services, and cross-border data flows. Trade liberalization is complex as negotiations are handled by the federal government, but states often regulate services, including licensing and certification requirements. While regulations may vary across states, they all must comply with the commitments made by the federal government in international trade agreements.

U.S.-Mexico-Canada Agreement (USMCA).

USMCA modernized and revised the former North America Free Trade Agreement (NAFTA), which included basic obligations such as transparency and nondiscrimination in a services trade chapter. USMCA has a new annex on express delivery and maintains NAFTA's separate chapters for financial services, telecommunications, and temporary entry (Mode 4). For telecommunications, USMCA has the effect of binding Mexico to its 2013 constitutional reforms, such as ensuring the independence of the regulator, without imposing new obligations on Canada or the United States. USMCA also has a new chapter on digital trade, with broad provisions on cross-border data flows and restrictions on data localization requirements. The financial services chapter has a similar provision to ensure the free flow of data and also regulator access to data for prudential reasons.

U.S.-Japan Digital Trade Agreement.

Signed in 2019, the deal parallels the USMCA digital trade chapter, but does not cover broader trade in services issues.

Issues for Congress

Potential policy issues for Congress to consider include**:**

Should TPA be updated to take into account rapid technological changes in the services sector? Should the USMCA and U.S.-Japan Digital Trade Agreement serve as a model for future sectoral negotiations on digital services?

What should U.S. trade negotiating priorities be for updating GATS and expanding other WTO members' commitments?

Should the executive branch pursue enhanced regulatory cooperation with key trading partners or join the ongoing WTO negotiation to lessen the burdens created by varied regulatory regimes across different markets?

Given the role of state regulators, how might U.S. policymakers involve them in ongoing and future trade negotiations or regulatory cooperation efforts?

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