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Soaring services trade: why service trade barriers are a potential retaliation tool

While global trade in goods often captures the spotlight, trade in services has been steadily growing, outpacing goods trade. However, services trade remains smaller due to non-tariff barriers. The US maintains a significant surplus in services, especially with the EU, Canada, and China. Retaliation in services may therefore yield better results

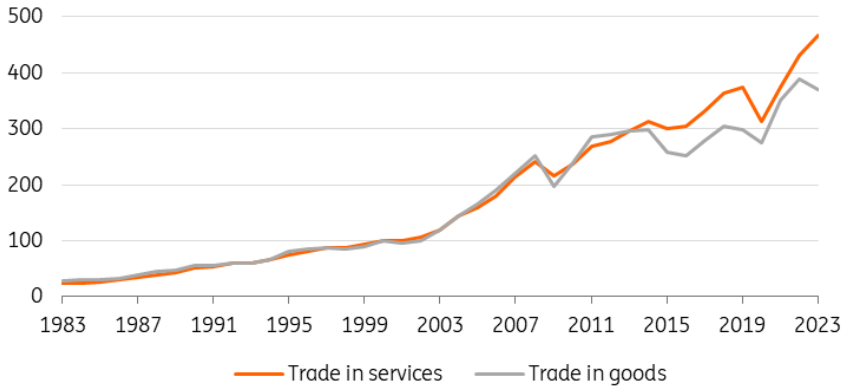
The steady rise of global services trade: outpacing goods amid 'slowbalisation'

While global trade in goods often captures the spotlight, trade in services has been quietly but steadily achieving remarkable growth. Unlike goods trade, where tangible items cross national borders, trade in services involves the exchange of intangibles between countries. This includes sectors such as tourism, transport, financial services, intellectual property, information and communication technologies (e.g., software development, data processing), as well as online courses, consulting, entertainment, media, and sports events.

Until the global financial crisis, services and goods trade grew at similar rates, but their paths soon began to diverge. As the growth of goods trade slowed, often termed 'slowbalisation,' services trade continued its upward trajectory with no peak in sight. In 2024, goods trade saw modest growth of 2%, while services trade increased by 7%, resulting in an overall trade growth rate of 3.3%, according to UNCTAD data.

Services trade leaving goods trade in the dust since 2007

World goods and services trade (Index 2000=100)



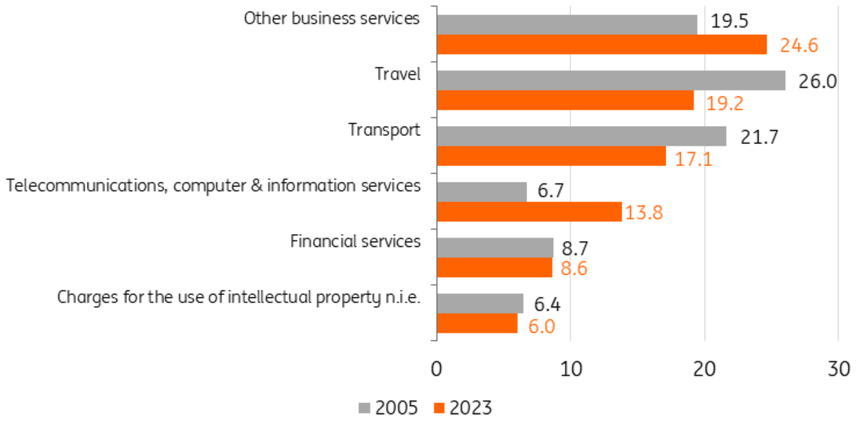
Source: LSEG Datastream, ING

Digitalisation a key driver of services growth

The divergence in goods and services trade can be attributed to several factors, including the increasing digitalisation of economies. Digitalisation has transformed how services are produced, delivered, and consumed. The advent of digital tools and platforms has enabled service providers to reach global markets more efficiently and cost-effectively. Telecommunications, computer and information services are key in supporting this digital evolution, with advances in telecommunications infrastructure, such as high-speed internet and mobile networks, facilitating connectivity. Professional and management consulting services, categorised under `other business services', have particularly benefitted from these advances.

Travel and transport services, on the other hand, have declined in relative importance. The global financial crisis initially impacted travel and transport services, traditionally linked to goods trade, and the Covid-19 pandemic further exacerbated this decline. Looking ahead, however, the increasing use of artificial intelligence, blockchain technology, and the growing importance of sustainability speak in favour of a further rise in services trade.

Sectoral service exports as a % of total service exports



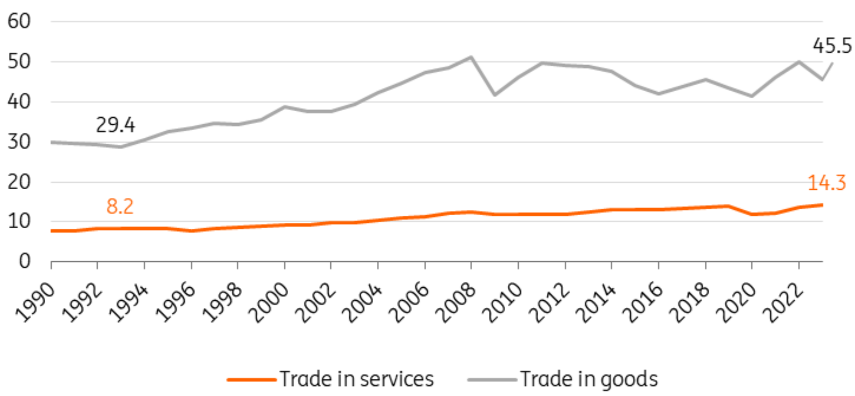
Source: UNCTAD, ING Research

Barriers to services trade – the untapped potential

Yet, despite the diverging growth patterns, services trade remains significantly smaller in size compared to goods trade. Even though services constitute a larger share of GDP than goods, trade in goods is much larger than trade in services. In 2023, world trade in goods amounted to 46% of GDP, compared to just 14% for services. Why is services trade punching below its weight?

World goods and services trade

(in % of GDP)



Source: LSEG Datastream, ING Research

Part of the answer can be found in a term currently generating a lot of discussion: 'non-tariff barriers'. As services cross a border in an intangible manner, it is near impossible to impose tariff barriers on them. Barriers to services often manifest as domestic regulations that impact both local and foreign providers, such as requirements for professional licensing and certification. As a result, service trade has benefited significantly less from the proliferation of Preferential Trade Agreements (PTAs) compared to goods trade over the past decades.

Liberalising such regulations within bilateral trade agreements remains rare, and policy restrictions in the service sector remain significantly larger than in the goods sector. According to the OECD, these restrictions translate into trade costs with average multilateral ad valorem equivalents (AVEs) of approximately 16% for communication services, 20% for business services, 23% for transport services, 190% for insurance services, and 211% for financial services. AVEs represent the additional costs of the existence of non-tariff measures (NTMs), calculated as a percentage of the import price of the product.

Mario Draghi, former president of the European Central Bank, recently emphasised the high internal barriers and regulatory hurdles as important impediments to within-EU trade. Effectively acting as tariffs, these barriers reduce the EU's growth potential as European service companies can insufficiently scale their activities in the absence of a true common market for services.

However, the higher the initial barriers to trade, the greater the potential gains from reducing those barriers. The service sector, in particular, holds significant potential for economic growth. Increased competition in this sector can lead to lower prices and economies of scale. And these benefits extend beyond final consumers, as the manufacturing industry heavily relies on intermediate services. In fact, services accounted for 25.5% of value-added in the European Union's manufacturing sector in 2022, and for 21.6% in non-EU countries, according to the FIGARO input-output tables. Liberalising trade in services positively impacts manufacturing sectors that use these services as intermediate inputs, enhancing productivity within the manufacturing sector, according to economists from the WTO.

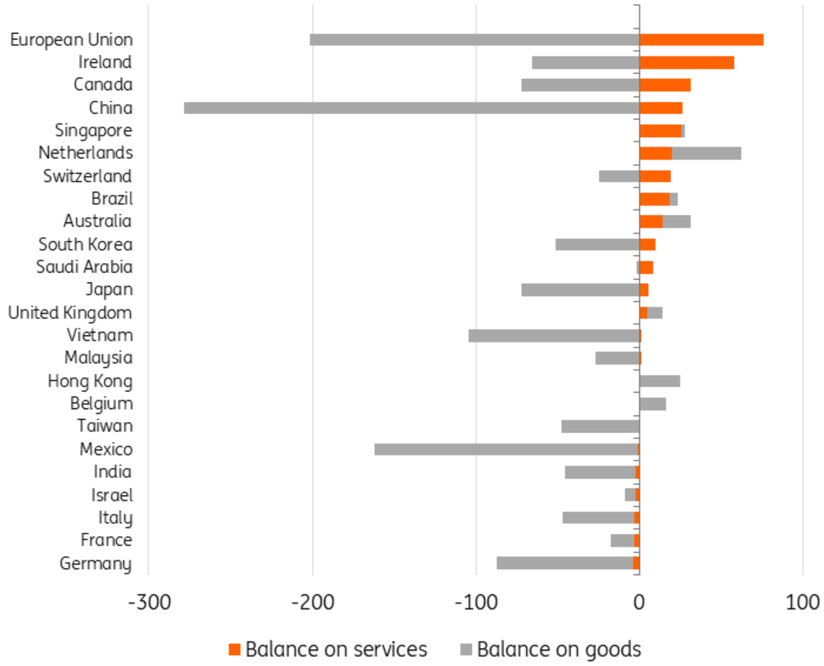
In this context, the progress towards reduced restrictions to services trade within the EU, led by the Single Market Enforcement Taskforce (SMET), appears slow. SMET has been working on various projects to address specific barriers, such as eliminating process barriers for renewable energy installations, tackling IBAN discrimination, and reducing administrative burdens for cross-border service providers. The pace of these efforts, however, has been gradual and significant challenges remain.

Meanwhile, the EU's first-ever digital trade agreement with Singapore, with negotiations formally concluded in 2024, marks a significant milestone for extra-EU trade. This agreement aims to facilitate digital trade by reducing administrative burdens and increasing legal predictability, ensuring cross-border data flow. The future of services trade holds immense potential, but decisive action is needed to fully unlock its benefits and drive economic growth.

The overlooked trade surplus: services in the US trade balance

While US President Trump is giving much attention to the US's trade deficits in goods, there's a significant yet often overlooked aspect: the trade surplus in services. Despite running large deficits with its major trading partners in goods, the US consistently maintains a positive trade balance in services with almost all of its trading partners, especially with the European Union (Ireland, Netherlands), Canada, and China. The US is the largest exporter of services in the world, followed by the United Kingdom and Germany.

The US's balance on goods and services in $bn (2023)



Source: US Bureau of Economic Analysis; ING

In 2023, the US exported services worth more than $1 trillion, contributing to a services trade surplus of $278.4bn. This surplus is driven by sectors such as financial services, intellectual property, and travel. Yet, the data hides one caveat: that trade in high-end services seems to be especially pronounced with low tax jurisdictions such as Ireland, a major hub for US software services, business consulting or R&D services. Targeting tax havens to reduce incentives for companies to shift profits to these jurisdictions might therefore soon be next on Trump's never-ending wish list.

For trading partners, though, focusing on services rather than goods to combat Trump's tariff agenda could potentially create a more balanced and strategic framework for trade negotiations. Threatening retaliation in the services sector might therefore yield better results than escalating trade tensions in goods.

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