Weekly Economic Commentary

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Exporting Good Old American Know-How Part 1

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Highlights

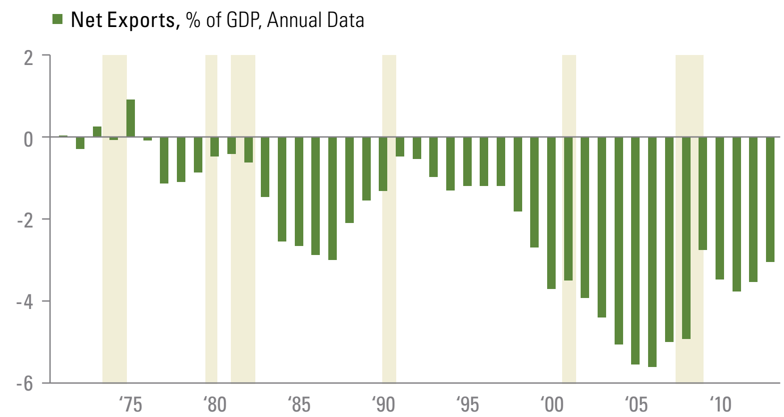
The United States has a trade surplus in the service sector, where we are creating relatively high-paying jobs.

Many U.S. service-related jobs require advanced degrees and advanced skills, and help to make possible our booming business in service exports, much of it tied to Good Old American Know-How.

Our competitive advantage in the service sector should help to continue to drive employment higher in this sector, especially in areas that require advanced skills.

The United States has run a trade deficit (importing more goods and services from other countries than it exports) since the mid-1970s. Although the trade deficit narrows during recessions, when imports typically fall faster than exports, the trade gap has increased over time, and currently stands at around 3.0% of gross domestic product (GDP) [Figure 1]. This large and persistent trade deficit acts as a drag on overall GDP growth, since sales of exports are added to GDP while purchases of imports are subtracted. Along with our massive budget deficit, the trade deficit is one of the major economic challenges facing the United States and has fostered the oft-repeated conventional wisdom that "we don't make anything in this country anymore," or "everything I buy or own is made in China." In this *Weekly Economic Commentary*, we will focus on the details of what we import and export and how that impacts the U.S. labor market. In a future commentary, we'll take a closer look at how "Good Old American Know-How" is boosting our exports and our labor market.

1 The United States Has Run a Trade Deficit Every Year Since the Mid-1970s



Source: Haver Analytics 08/08/14

Shaded areas indicate recession.

Inside Look at U.S. Trade Deficit

The trade deficit is computed by adding up the value of all goods and services made in the United States and shipped to other countries, and subtracting the value of all goods and services from abroad purchased in

The composition of the deficit on the goods side (what we import) contributes to the notion that "we don't make anything in the United States anymore," while the "hidden" surplus on the service side gets little attention.

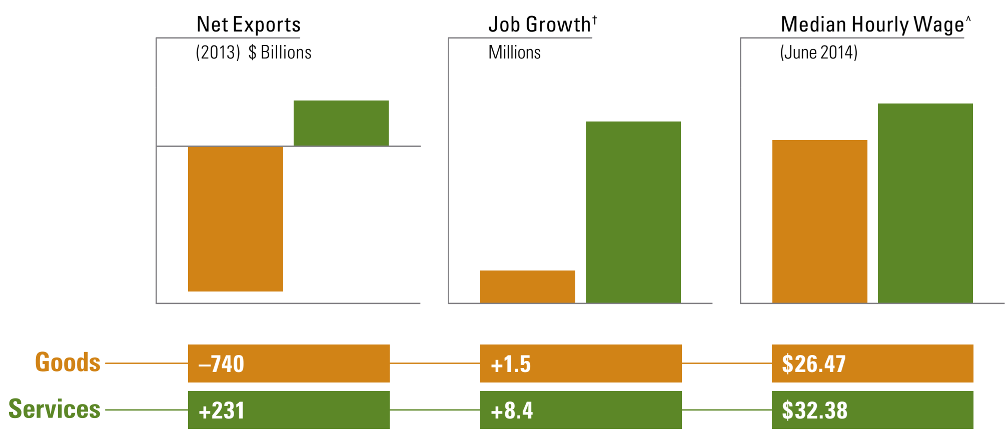
the United States. Our large deficit on the goods side ($740 billion in 2013*) more than offsets the trade surplus we have on the service side of the ledger (around $231 billion in 2013). Combined, our goods and services trade deficit was $509 billion in 2013. The composition of the deficit on the goods side (what we import) contributes to the notion that "we don't make anything in the United States anymore," while the "hidden" surplus on the service side gets little attention.

*Import and export data on both goods and services are available monthly, but for ease of comparison we will limit our discussion to the annual data for 2013.

Trade Surplus and Where the Jobs Are

Figure 2 helps to illustrate the point that where we have a trade surplus (in the service sector), we create jobs, and relatively high paying jobs. As noted previously, the United States ran a $740 billion trade deficit in the goods sector in 2013. Just 1.5 million jobs have been added in the goods-producing sector since the trough in the labor market in early 2010. In June 2014, the median hourly wage in the goods-producing sector was $26.47. In contrast, we ran a $231 billion trade surplus in the service sector, where 8.4 million jobs have been added since the February 2010 nadir in employment. In addition, in the areas where we have the largest service sector trade advantage (professional and technical services, motion pictures, broadcasting, performing arts and sports, insurance carriers, securities, commodities and investments, data processing and hosting, etc.) the median hourly wage as of June 2014 ($32.38) is more than 20% above the median hourly wage in manufacturing, construction, and mining and natural resources. In general, jobs in the export-oriented service sector require more advanced skills and, in most cases, advanced education and training.

2 Job Growth Has Come in the Service Sector, Where We Are Net Exporters



Source: LPL Financial 08/08/14

†Since trough in employment (February 2010).

^Goods industries: Manufacturing-durable; Manufacturing-non durable; Construction; Natural resources & mining. Services industries: Motion picture sound & recording; Broadcasting ex-internet; Telecomm; Data processing & hosting; Other information services; Securities, commodity contracts, investments; Insurance carriers & related; Professional & technical services; Performing arts & sports; Accommodation & food.

That is not to say that the goods manufacturing sector is not creating any new jobs or will not create any in the coming years. Indeed, aided by much cheaper energy inputs, a flexible and well educated labor force, higher quality control standards along with some well placed "arm twisting" from federal, state, and local governments, a few bright spots have emerged in the manufacturing economy in recent years. The sector created 707,000 jobs since the trough in employment in early 2010, the best performance over a similar time frame since 1998, and more jobs in this area are likely on the way. The caveat here is that all of the manufacturing jobs created since early 2010 have been in durable manufacturing (autos and light trucks, appliances, fabricated metal products, and machinery), all areas that mostly require advanced skills. The non-durable manufacturing area has shed 5,000 jobs over this time frame, and non-durable goods are where the United States does not have a particular competitive advantage.

Consumer and Consumer-Related Items Dominate U.S. Goods Imports

The list of our top-10 imported items is full of consumer and consumer-related items like apparel, computers and electronic equipment, oil and gas, petroleum and coal, semiconductors, and the somewhat deceiving "miscellaneous manufactured goods" category. This category of imported goods, which includes household items like jewelry, sporting goods, toys and games, office supplies, etc., is found in the grocery stores and big box discount stores we shop in every day. We imported $108 billion of these goods in 2013 and exported just $44 billion, resulting in a trade deficit of $64 billion. Although this category is not the main driver of our overall trade deficit, it is certainly one of the most visible manifestations of it and contributes to the overall perception that "we don't make anything here anymore." Employment in this area of manufacturing peaked in the 1970s at around seven million workers. Today, only 4.5 million people are employed in the manufacturing of non-durable goods.

U.S. Service Exports Are Growing Rapidly, With More Than 50% Headed to Emerging Markets

On balance, 80% of U.S. jobs are service-related, and although much is made of the maligned "hamburger flipper" service job, many U.S. service-related jobs require advanced degrees and advanced skills and help to make possible our booming business in service exports, much of it tied to Good Old American Know-How.

What is not as visible to most Americans (and to most pundits and media outlets) is that the United States is a net exporter of services, and that our service exports are growing rapidly, as consumers and businesses around the world demand America's intellectual property and expertise — and culture too. Service exports were at an all-time high in 2013, and have nearly tripled in the past 10 years. About half of these service exports go to developed nations — with 30% headed to Europe. In recent quarters, service exports to the Eurozone have slowed dramatically, as the Eurozone economy has struggled to regain its footing after the Great Recession and its aftermath. Looking ahead, this is an area of concern for us. However, more than 50% of our service exports go to fast-growing emerging market economies, with Mexico (18%) and China (6%) leading the way.

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