The United States Is Edging towards a Comparative Advantage in Services

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First clues

Indications abound as to the comparative advantage of the United States in services. In the first decade of this century the ratio of service exports to imports reached 121 percent, whereas for goods it was only 53 percent (61 percent excluding oil). The proportion of American multinationals that work for subsidiaries abroad (mostly in industry) also rose from 21.4 percent in 1989 to 32.3 percent in 2009. The share of R&D spending going to foreign subsidiaries soared from 9 percent to 15.6 percent, and that of capital investment rose from 21.8 percent to 29.6 percent during the same period. In a *Harvard Business Review* survey, alumni reported that when their firms had to decide whether to do something in the United States or elsewhere, the United States lost two times out of three.[1]

Evidence

The surprising news is that this trend is still going strong, and even accelerating. Table 1 presents the evolution of productivity in industry and services over 12 years in the United States and in Germany-France. The gap between services and industry thus rose by a huge 1.7 percent (= 1.4 percent + 0.3 percent) annually, which is of the order of magnitude of GNP-growth. In fact, while four items in eight of services showed a net import for the United States in 1986 – passenger fares, other transportation, telecommunication and insurance – only the last one remained negative in 2011.

Table 1

Indices of productivity (1995–2007)

	Industry	Services
US	117%	115%
Germany-France (G-F)	122%	98%
Ratio US/G-F	0.96 (– 0.3 yearly)	1.17 (+ 1.4 yearly)

Source: The Economist, 18 February 2012, 24.

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[1] See The Economist, “This Time It Is Serious”, 18 February 2012, 57.

Table 2

Shares of services of total value added and employment and ratio of services to industry productivities (both in %) – 2010

Position	Countries	Value added (1)	Active population (2)	Productivity (3)
1	Hong Kong	92.3	85	107.3
2	Luxembourg	86	80.6	106.7
3	Canada	78	77.3	102.6
4	US	76.7	79.1	97
5	Denmark	76.1	77.3	98.4
6	Singapore	72.8	69.7	104.4
7	Netherlands	72.4	80	90.5
8	Sweden	72.2	70.7	102.1
9	Australia	71.2	76	94.9
10	Switzerland	71.2	73.2	97.3
11	Ireland	70	75	92.1
12	Iceland	69.9	76	95.8
	Median	72.4	76	97.8

Source: CIA World Factbook (2012).

Table 3
Share of two large countries in import of goods in 2009

	Germany	Japan
Australia	5.3	8.4
US	4.6	6.2
Mexico	4.1	4.8
Canada	4	3.7
Iceland	3.9	3.6
Germany	–	4
Japan	3.2	–

Source: CIA World Factbook (2012).

Table 2 provides additional evidence of the high share of services in the US economy. It shows that this is not due to high income per head as the table compares the United States with countries enjoying comparable welfare. The high figures for Hong Kong and Luxembourg come as no surprise. The United States is fourth in columns (1) and (2) in the same table. It would even be closer to the top if we considered private services only, as the share of public services are low in the United States. Note that Canada even ranks above the United States in columns (1) and (3), indicating

Table 4
Ratio of public expenditure in education and gross fixed investment (2008)

Rank	Country	Score (in %)	Rank	Country	Score (in %)
1	Cuba	87	40	Turkey	20
2	Sweden	47	41	Philippines	20
3	Denmark	44	42	Australia	19
4	Norway	43	43	Chile	19
5	Israel	42	44	Luxembourg	19
6	Finland	34	45	India	19
7	Cyprus	34	46	Slovakia	17
8	Belgium	33	47	Bulgaria	17
9	North Korea	33	48	Jamaica	17
10	UK	32	49	Egypt	17
11	Iceland	31	50	Iran	17
12	Poland	31	51	Peru	17
13	US	30	52	Ireland	16
14	New Zealand	29	53	Greece	16
15	Morocco	29	54	Spain	16
16	Tunisia	28	55	Nepal	16
17	Switzerland	28	56	Singapore	16
18	Mexico	27	57	Croatia	16
19	Lithuania	27	58	Thailand	16
20	Austria	27	59	Czech Republic	16
21	Germany	27	60	Rumania	16
22	Canada	26	61	South Korea	15
23	Netherlands	26	62	Japan	15
24	Portugal	26	63	Kazakhstan	15
25	Panama	25	64	Pakistan	14
26	Italy	25	65	Sri Lanka	13
27	Hungary	24	66	Vietnam	13
28	Slovenia	24	67	Nicaragua	12
29	Uruguay	23	68	Albania	11
30	Brazil	22	69	Georgia	11
31	Argentina	22	70	Bangladesh	10
32	Mongolia	22	71	Myanmar	10
33	Belarus	22	72	Cambodia	8
34	Hong Kong	22	73	China	5
35	Russia	21	74	Ecuador	5
36	Ukraine	21	75	Dominican Republic	5
37	Latvia	21	76	Indonesia	5
38	Taiwan	21	77	Haiti	4
39	Senegal	20	**Median**	20	

Source: L'état du monde en 2010.

that Canada is following in the footsteps of its big neighbour. As for productivity, the United States only ranks eighth, which could be due to the longer working hours in Asian countries (shops, restaurants, etc.), to the generally superior level of education of manpower in almost all nations (languages, math) and to their higher level of investment (especially Singapore, Hong Kong and Canada). It is also worth noting the correlation between columns (2) and (3) for most countries – Hong Kong, Luxembourg, Denmark, Canada, Iceland, Australia and the United States – showing that where productivity, and thus wages, are high, manpower is attracted to services.

Moreover, we would expect from comparative cost theory that nations with a comparative advantage would import a lot from countries with an advantage in industry – *pace* theory of intra-industry trade – such as Germany and Japan. Table 3 lists their share in the merchandise import of countries, eliminating the cases where proximity (except to some extent, for Australia) or a customs union would bias the comparison. The United States ranks second in both cases and may even rank first in the last case if the proximity of Australia and Japan were corrected. It is also worth noting the high rank correlation between the two columns: 0.84, which is significant at the 10 percent level of the two-tail test (for Germany and Japan, we consider the flows 4.0 and 3.2): trade with Germany and Japan, both with a comparative advantage in industry, is positively correlated. This strengthens our conclusion. As for the *export* of merchandise to Germany and Japan from the United States, we would expect it to be low compared with *import* as the United States specializes in services: indeed, this figure amounts respectively to 58 percent and 50 percent, which both lie far below the overall rate of export to import of 67 percent.

Finally, when a country specialises in services, this would lead us to assume that it invests more in human than in physical capital. Table 4 illustrates the ratio of public expenditure in education and gross fixed investment in different countries. Of course, this table also reflects factors other than static specialisation: the scores are also influenced by the dynamics of specialisation, as evidenced by the low data for China and Indonesia, showing the rapid industrialisation of these countries, which requires much physical capital. Yet, in general, the scores do tally with the statistics of Table 2, namely the high rank of Sweden, Denmark, Iceland, Switzerland, Canada and the Netherlands. In this decade, finance, intellectual services, dividends from abroad and the four t's (trade, transportation, teaching and tourism) will be the milk cows of the American economy and its balance of payments.[2]

[2] According to the Boston Consulting Group, the most threatened industries are: machinery, electrical apparatus and electronics.