Globalization and Business Services: A Growth Opportunity?

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The service sector now accounts for the lion's share of employment in the United States, and it continues to expand. A broad measure of the service sector accounts for about 85 percent of U.S. employment and is growing. By contrast, over the past 50 years, employment in the goods-producing sector (manufacturing, mining, agriculture, and construction) has steadily declined. In 2007, the manufacturing sector accounted for only about 10 percent of U.S. employment.

In spite of these trends, services have often been treated as an afterthought by policymakers, especially in the area of trade policy, where the focus has tended to be on agriculture and manufactured goods. The important role of the service sector in the U.S. economy has been underappreciated and misunderstood for several reasons. First, there has been a long-running assumption that manufacturing is more important than the service sector. Second, many falsely believe that manufacturing jobs are "good jobs" and that service jobs are "burger-flipper" jobs. Third, the service sector is large and diverse, making it difficult to characterize. Finally, although official statistics on the service sector are more available than ever before, data collection still lags that collected for agriculture and manufacturing.

A Closer Look – Business Services

The broad scope of the service sector can make it hard to grasp. Depending on how "services" is defined, the sector could include government; trade, transportation, and utilities; and private services, which can be further, refined into two categories of private services: professional (or business) services and personal services. With this many disparate pieces, the service sector is simply too big and too diverse to analyze in a meaningful way as a whole. To make this task more manageable, let's take a closer look at what I'll call the business services sector.

The North American Industrial Classification System (NAICS) lists the following major professional services sectors: information (publishing, software, telecommunications, and the Internet); finance and insurance; real estate; professional, scientific, and technical services (accounting, legal, consulting, and engineering); management of companies and enterprises; and administrative and waste remediation services.

While this is a seemingly specialized portion of the economy, it is actually quite large. As defined above, the business services sector accounts for 25 percent of employment in the U.S. – more than *twice* the size of the manufacturing sector. In further contrast with the

manufacturing sector, business services sector employment *increased* almost 30 percent from 1997-2007; by contrast, the manufacturing sector *decreased* in size by over 20 percent during that time.[1] In 1960, employment in the U.S. professional services sector was half the size of employment in the manufacturing sector; in 2007, professional services was twice the size of the manufacturing sector in terms of employment.

Quality and size

Moreover, the popular perception that service jobs are "bad jobs with low wages" is wrong. In fact, the business services sector pays significantly higher salaries and wages than the manufacturing sector. Average wages in the manufacturing sector in 2007 were about $46,000. In business services, the average wage was about $56,000 – more than 22 percent higher than in manufacturing.[2] The business service sector is large, growing, and provides good jobs at good wages.

Another common impression of the service sector is that service firms are small, relative to manufacturing firms, and therefore less important. While it is true that most establishments in the service sector are small compared to manufacturing plants, the average worker in the business services sector actually works in an establishment that is significantly larger (about 1,500 workers) than the plant where the average manufacturing worker works (about 950 workers).[3] This shows that the average size of service establishments is a misleading statistic regarding the importance of large producers in services. While the service sector may be characterized by a much larger population of very small establishments than manufacturing, most service workers nonetheless work in relatively large establishments.

Are services tradable?

Services have long been treated as "non-tradable" – that is, economists and policy-makers have assumed that services cannot be provided at a distance. This has always been a simplification, but it is increasingly inappropriate. Falling travel, communication, and IT hardware costs and increasing access to the Internet have increased opportunities for trading services. And, indeed, official statistics suggest that U.S. services trade is growing rapidly. Over the past ten years, service imports and service exports both more than doubled – and much of the growth was accounted for by increased trade in business services. Services trade accounts for approximately 30% of U.S. exports and 15% of U.S. imports. The United States has consistently maintained a positive trade balance in services, suggesting comparative advantage in tradable services.

Growth in the business services sector in the United States and other countries, combined with falling travel costs, falling telecommunications costs, and an increased ability to digitize information suggest that the potential for exporting is huge. Estimates suggest that about 70 percent of employment in business services is in activities that could be

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[1] 2007 Economic Census.
[2] 2007 Economic Census.
[3] Author's calculations using 2002 Economic Census.

traded.[4] Increasingly, organizations can trade a broad range of services, known as information technology–enabled services. Not just limited to computer programming or database administration, these technology–enabled services can include accounting services, financial analysis, call-center services, architectural drafting, health-record transcription, and so on. Technology drives the potential globalization of these activities.

What is interesting to note about "tradable" service jobs is that they are qualitatively different than "non-tradable" service sector jobs. Workers in tradable service jobs have higher education levels and significantly higher earnings. Workers in tradable service industries are twice as likely to have a college degree and twice as likely to have an advanced degree as workers in manufacturing. Within service industries, workers in tradable activities earn almost 20 percent more than workers with similar education and experience in non-tradable activities.[5]

The prospect of offshoring

If the tradable jobs are high-wage, high-skill jobs, aren't these the jobs most likely to be "lost" to low-wage, labor-abundant import competition? This concern not only ignores over a century of international trade theory and empirical research, but it also it ignores the facts.

Here, a comparison to the manufacturing sector is useful. We know there is considerable variation across manufacturing industries in terms of average wages, capital intensity, and productivity. For example, apparel production tends to be labor intensive and relatively low wage, while chemicals and transportation equipment production tend to be capital intensive and high wage. U.S. apparel producers face high levels of low-wage import competition and are less export intensive than higher-skill, higher-wage industries; by contrast, skill-intensive and capital-intensive industries such as aircraft tend to have higher exports (and lower imports from low-wage countries). We see similar patterns for exports in the service sector, suggesting that comparative advantage will play out the same way in services as it has in manufacturing.

Opportunities for exports?

The U.S. appears to have a comparative advantage in the high-skill, high-wage business services sector jobs that are tradable. Yet, the sector still lags behind manufacturing in terms of participation in exporting. About 25 percent of manufacturing plants export; in business services, only about 5 percent export.[6] Exports-to-sales ratios for service exporters are slightly lower than those in manufacturing. These statistics suggest that there continue to be significant impediments to trade in services, possible including culture and language differences, technological barriers, or policy impediments.

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[4] Jensen and Kletzer (2006).
[5] Jensen and Kletzer (2006).
[6] Jensen and Kletzer (2008).

This is unfortunate, as exporters within the business services sector show the same desirable characteristics as exporters in manufacturing – large size, high productivity, and high wages. In fact, exporter wage premia in business services are double what they are in manufacturing. Comparing exporters within services without taking industry into account, exporters pay 40 percent higher wages. If we compare exporters within an industry, exporters pay 20 percent higher wages even within the same well-specified industry.[7]

How public policy can help

The United States appears to be well-situated to take advantage of increased trade in services, yet participation in export markets by service firms seems to lag. Why? Public policy and further research could help us better understand the impediments to services trade.

To what extent are language and culture impediments to services trade? It seems possible that these would prove to be greater impediments to services trade than goods trade. And while tariffs barriers seem to be less a problem for services than goods, what role do other policies – including regulatory systems, licensing and accreditation standards, and the lack of intellectual property protection – play in impeding services trade? Are limits on foreign direct investment a barrier to services trade? Do trade agreements ease these constraints? These important questions require research and analysis to show the way toward increased trade in services.

The government can play a very constructive role in collecting and disseminating more and better data on the service sector in general and trade in services in particular. Current statistics on trade in services are not detailed enough to support robust empirical analysis. As an example, official statistics report about 30 categories for trade in services as opposed to around 10,000 categories for merchandise trade. Only three years ago, only 17 service trade categories were available. So, while the published aggregates are moving in the right direction, we clearly have far to go.

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[7] Jensen and Kletzer (2008).