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 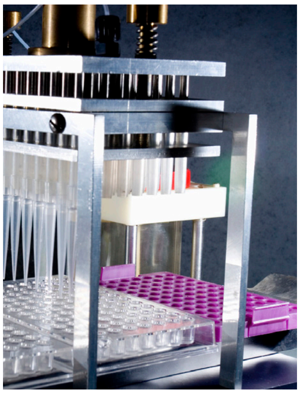 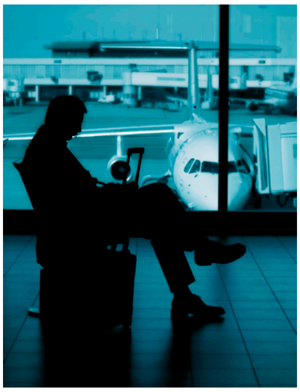 

May 2012

# Trading myths: Addressing misconceptions about trade, jobs, and competitiveness

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# Trading myths: Addressing misconceptions about trade, jobs, and competitiveness


Charles Roxburgh
James Manyika
Richard Dobbs
Jan Mischke

# The truth …

**0.1%** of GDP improvement in mature economies' aggregate balance of trade, 2001–2011

**1.3%** of GDP trade surplus on knowledge-intensive manufacturing in 2009

**0.5%** trade surplus on manufactured goods in 2008

…but a **3.3%** of GDP deficit in primary resources trade

**$1.9 trillion** annual service exports of mature economies

**$113 billion** trade surplus for mature economies in business services, despite offshoring

# *... about trade*

By closing its entire 2010 current account deficit via manufacturing exports, the United States could bring manufacturing employment back to the levels of 2007

6 million

net jobs shifted from labor-intensive to knowledge-intensive sectors due to trade

15 million

new jobs in mature economies' knowledge-intensive services, 1996–2006

$173 billion

net service exports by the EU-15

vs. $129 billion

for the United States

# Trading myths: Addressing misconceptions about trade, jobs, and competitiveness

Mature economies face multiple—and serious—challenges in the aftermath of the global financial crisis.[1] While each economy and region has its own particular issues, growth remains anemic across mature economies. Government debt has risen to potentially unsustainable levels, unemployment is high, and income inequality is rising. Many mature economies need to pay down high levels of public and private debt. This period of deleveraging is likely to be prolonged, if history is a guide, and will act as a drag on growth.[2]

Many policy makers are, therefore, turning to efforts to boost investment and net exports to sustain growth and employment at a time when domestic consumption is expected to remain weak. Particular hopes and focus rest on the manufacturing sector. Many perceive that ground in manufacturing is progressively being lost to emerging economies. But efforts to stimulate exports face a threat from a growing risk of direct protectionism and actions to weaken currencies to improve competitiveness. The unfortunate failure of the Doha Round is an additional concerning element. Were this risk of greater protectionism to materialize—and the world to engage in tit-for-tat trade restrictions—the global recovery would be imperiled.

It is therefore vital that the political and public debate around trade and its impact be rooted in facts. With this in mind, MGI has analyzed the performance of 17 mature economies in tradable sectors, which importantly include services as well as manufacturing. We find that the reality is often at odds with conventional wisdom, raising important implications for policy makers and corporations. We focus the main body of the analysis on mature economies in aggregate, to see whether there is any predetermined fate common to them, but also point out notable differences. Appendix A provides a brief review of the situation in each of the 17 mature economies we examined.

1 We analyze a group of mature countries that we call "mature economies," comprising the European Union (EU)-15, the United States, and Japan. This group excludes high-growth Asian Tigers (Singapore, Hong Kong, Taiwan, and South Korea); new member states of the EU; economies that are major exporters of resources (Canada, Australia, and Norway), which face a different set of challenges than those shared by other developed economies; and Iceland, New Zealand, and Switzerland because of a lack of comparative data.

2 MGI research has found that historical deleveraging episodes have been painful, on average lasting six to seven years. See *Debt and deleveraging: Uneven progress on the path to growth*, McKinsey Global Institute, January 2012 (www.mckinsey.com/mgi).

## MYTH 1: MATURE ECONOMIES ARE LOSING OUT TO EMERGING MARKETS IN TRADE AND THUS FACE INCREASING TRADE DEFICITS

**Reality:** The trade balance for mature economies in aggregate has remained largely stable and in fact has begun to improve. Wide variations exist between individual countries, and the gulf between deficit countries like the United States, United Kingdom, and Southern Europe and surplus economies in Northern and Continental Europe needs to narrow. But there is no evidence to support the view that there has been a wholesale deterioration in the trade balance between mature and emerging economies over the past decade. In fact, the balance of trade in goods and services of minus 1.5 percent of GDP in 2011 was slightly better than a decade earlier.

## MYTH 2: MANUFACTURED GOODS DRIVE TRADE DEFICITS

**Reality:** Imports of primary resources, whose prices have been rising sharply, were the largest negative contributor to the trade balance of mature economies. In 2008, mature economies ran a deficit of 3.3 percent of GDP in their trade in primary resources. Even the United States and United Kingdom, two economies with significant domestic oil production, saw a deterioration in their primary resource trade balances over the past decade similar to mature economies in aggregate.

In contrast, mature economies ran a small surplus of 0.3 percent of GDP on all manufactured goods and a significant surplus of 1.3 percent of GDP in knowledge-intensive manufacturing in 2009. Exceptions are the United States, the United Kingdom, Spain, Portugal, and Greece, all of which ran trade deficits on knowledge-intensive manufacturing, and past MGI research has shown the declining US competitiveness in those sectors.[3]

## MYTH 3: TRADE IS AT THE HEART OF THE LOSS OF MANUFACTURING JOBS

**Reality:** The decline in manufacturing jobs in mature economies—and the shift in jobs among sectors overall—is dominated by changes in the composition of demand and ongoing increases in productivity. The share of manufacturing employment in mature economies is bound to decline further, from 12 percent today to below 10 percent in 2030, according to our analysis.

In the case of the United States, the 5.8 million manufacturing job losses from 2000 to 2010 largely reflected ongoing productivity increases coupled with reduced output mostly explained by weak domestic demand after the recession, even when we adjust for widely discussed difficulties in measuring productivity. Historically, rising productivity is accompanied by strong increases in demand and ouput. However, this latest decade was one in which increased productivity coincided with stagnation in domestic demand in real terms as the recession reversed previous increases.[4] According to our analysis, around 20 percent of the decline in jobs can be attributed to trade or offshoring. Closing the entire 2010 US current account deficit of 3.2 percent of GDP by improving the

3 See *Growth and competitiveness in the United States: The role of its multinational companies*, McKinsey Global Institute, June 2010; and *Growth and renewal in the United States: Retooling America's economic engine*, McKinsey Global Institute, February 2011. Both are available at www.mckinsey.com/mgi.

4 Adjusting for hedonic deflation in electronics.

manufacturing trade balance would be equivalent to approximately 2.2 million more manufacturing jobs—well short of the job losses of the past decade alone.[5]

## MYTH 4: MATURE ECONOMIES CREATE JOBS ONLY IN LOW-PAID, LOW-VALUE DOMESTIC SERVICES

**Reality:** Mature economies continue to create high-value, knowledge-intensive jobs in tradable sectors—but more in services than in manufacturing. From 1996 to 2006, mature economies created 15 million jobs in knowledge-intensive services, a share of them related to increasing exports of knowledge services. Wages in service sectors are comparable when we look at factor intensity, and it is demonstrable that tradable service jobs offer some of the best wages in these economies.[6] In any case, the boundaries between manufacturing and services appear increasingly blurred, as manufacturers move into service-type activities such as sales and customer care that, for instance, accounted for 39 percent of Sweden's manufacturing employment in 2007. And manufacturers build global supply chains of service- and assembly-type activities with strong links to service suppliers. In Germany, service suppliers already contribute 34 percent of the total domestic value added in manufacturing exports. Manufacturing and services appear entirely synergistic.

## MYTH 5: SERVICE TRADE IS SMALL, AND EMERGING ECONOMIES WITH LOW-COST TALENT WILL CAPTURE ANY INCREASE

**Reality:** Service exports already make up one-quarter of the overall exports of mature economies, and that share could rise to one-third by 2030. When we adjust for the high services and import content in manufacturing exports, services value added exported greatly exceeds the manufacturing value added embedded in exports in a number of economies. And, despite fears of offshoring, mature economies are running increasing surpluses in services, particularly in knowledge-intensive services that generated a strong and rapidly growing trade surplus of 0.7 percent of GDP for mature economies in 2008.

## MYTH 6: "SERVICE ECONOMIES" SUCH AS THE UNITED STATES ARE THE WORLD LEADERS IN SERVICE TRADE

**Reality:** The European Union (EU) is ahead of the United States in service exports in both gross and net terms, even when we look at only extra-EU trade (gross exports of 4.6 vs. 3.5 percent of GDP, respectively, in 2009). Even Germany's service exports amounted to 7.1 percent of its GDP (of which 3.3 percentage points were extra-EU exports).

5 Please note that, because we look at the net impact over a prolonged period, this does not by any means preclude further negative transitional impact on individual companies, sectors, or regions. Also, in the current economic context, improving manufacturing net exports would have significant multiplier effects also on service jobs—but manufacturing jobs in themselves look unlikely to ever again return to even their 2000 levels, and similar multipliers and positive effects on aggregate demand could arise from reducing primary resource imports or improving the balance of trade in services.

6 J. B. Jensen, *Global trade in services: Fear, facts, and offshoring*, Peterson Institute for International Economics, August 2011.

## CLARITY ON THE FACTS HAS IMPORTANT IMPLICATIONS FOR POLICY

With these facts in mind, it is important that mature economies fully realize the opportunities of growth in emerging markets rather than being fearful of the rise of these new economies. Above all, political leaders should resist protectionist pressures. In particular, they should push vigorously for fuller liberalization of trade in services, where restrictions remain high. Trade-related policy should be geared to supporting, and benefiting from, comparative advantage in attractive stages of global value chains and avoiding an emphasis on sustaining or creating direct employment through manufacturing exports. Any improvement in net trade will offset the headwinds caused by deleveraging and, therefore, domestic job creation. An important, but under-emphasized, lever for improving net exports is an intensified push for more resource productivity. Continued investment in education, infrastructure, and innovation will be necessary to sustain that comparative advantage and continue to create high-value jobs. Economic statistics and trade measurements must also improve so that they can provide a quantitative understanding of global value chains, as well as robust and sufficiently granular reporting in service trade.

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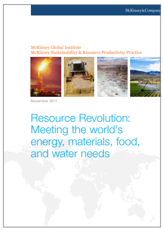


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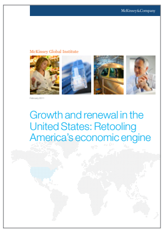


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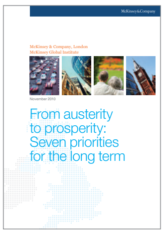


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