Weekly Economic Commentary

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Exporting Good Old American Know-How

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Highlights

Our top service export, business, professional, and technical services (at $153 billion in 2012) is a fancy name for 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.

Our reliance on exports (and employment) in the less volatile service sector, which continue to be in high demand in fast growing emerging markets worldwide, should help to promote longer U.S. economic expansions.

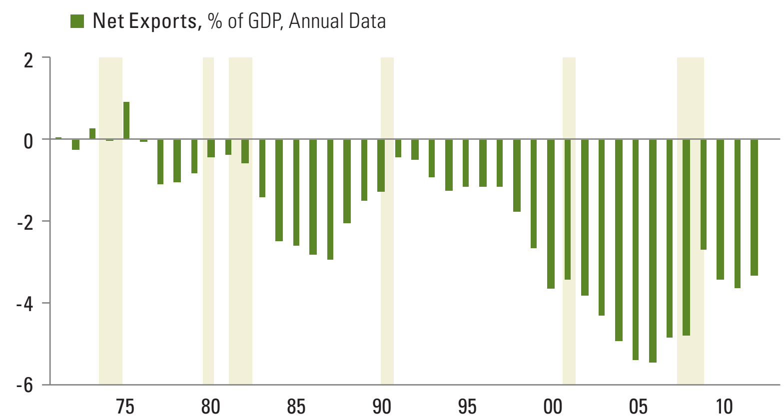
Please see the LPL Financial Research Weekly Calendar on page 3

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—imports typically fall faster than exports during a recession—the trade gap has increased over time, and currently stands at around 3.5% 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 week's *Weekly Economic Commentary*, we focus on the details of what we import and export and how that impacts the U.S. labor market.

Inside Look at U.S. Trade Deficit

The trade deficit is computed by adding up the value of all the goods and services made in the United States and shipped to other countries, and subtracting the value of all the goods and services from abroad purchased in the U.S. Our large deficit on the goods side (around $759 billion in 2012*) more than offsets the trade surplus (around $213 billion in 2012) we have

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



Source: Haver Analytics 08/15/13

Shaded areas indicate recession.

*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 2012.

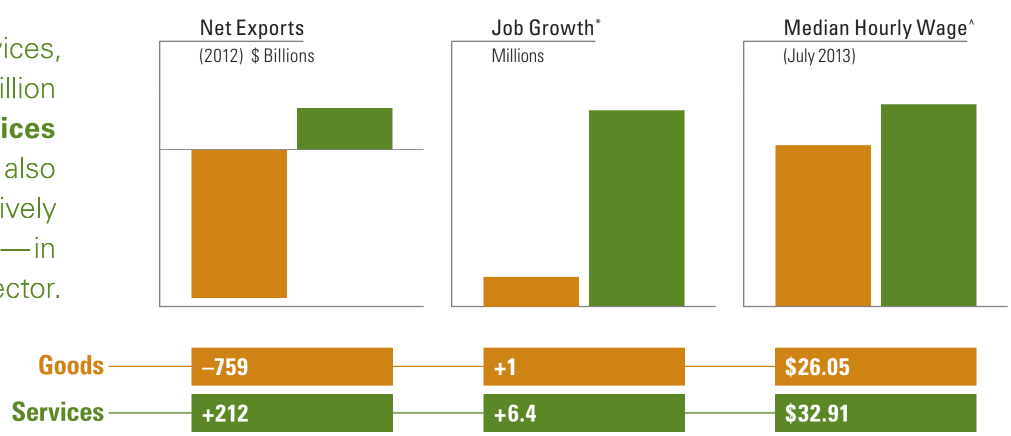
on the service side of the ledger. Combined, our goods and services trade deficit was $547 billion in 2012. The composition of the deficit on the goods side (what we import) contributes to the notion that "we don't make anything in the U.S. anymore," while the "hidden" surplus on the service side gets little attention.

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 $759 billion trade deficit in the goods sector in 2012. Just 1 million jobs have been added in the goods-producing sector since the trough in the labor market in early 2010. The median hourly wage in the goods-producing sector is $26.05. In contrast, we run a $213 billion trade surplus in the service sector, where 6.4 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 ($32.91) is more than 25% above the median hourly wage in manufacturing, construction, and mining and natural resources ($26.05). In general, the jobs in the export-oriented service sector require more advanced skills, and, in most cases, advanced education and training.

We exported $660 billion of services, while importing around $448 billion for a **trade surplus on services** of nearly $213 billion. We are also creating jobs — and relatively high paying ones — in the service sector.

2 U.S. Goods Versus Services



Source: LPL Financial 08/15/13

*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 carries & related; Funds, trust & other; Professional & technical services; Performing arts & sports; Accommodation & food.

LPL Financial Research Weekly Calendar

2013	U.S. Data	Fed	Global Notables
19 Aug			▪ Japan: Trade Balance (Jul)
20 Aug			
21 Aug	▪ **Existing Home Sales (Jul)**	▪ **FOMC Minutes**	▪ **China: Markit PMI (Aug)** ▪ Thailand: Central Bank Meeting
22 Aug	▪ **Markit PMI (Aug)** ▪ Leading Indicators (Jul) ▪ Initial Claims (8/17)	▪ **Jackson Hole Symposium** Fisher	▪ **Eurzone: Markit PMI (Aug)**
23 Aug	▪ **New Home Sales (Jul)**	▪ **Jackson Hole Symposium**	▪ Eurozone: Consumer Confidence (Aug)

Hawks: Fed officials who favor the low inflation side of the Fed's dual mandate of low inflation and full employment

Doves: Fed officials who favor the full employment side of the Fed's dual mandate

* Voting members of the Federal Open Market Committee (FOMC)

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, a high unemployment rate, and 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 has created 530,000 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 95% 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. Just a handful of jobs have been created in the non-durable manufacturing area, 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, transportation equipment, oil and gas, petroleum and coal, 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 $102 billion of these goods in 2012 and exported just $44 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 1978 at around 7 million workers. Today, only 4.5 million people are employed in the manufacturing of non-durable goods.

3 Breakdown of U.S. Trade in the Service Sector, *2012, $ Billions*

	Exports	Imports	Balance
Total Service Sector	**628**	**415**	**213**
Travel	126	83	43
Passenger Fares	39	35	4
Other transportation services	44	55	-11
Royalties and license fees	124	40	84
Education	25	6	19
Financial Services	76	17	59
Insurance services	16	53	-37
Telecom	14	8	6
Business, professional, and technical services	153	116	37
Other services	10	1	9

Source: US Department of Commerce 08/19/13

Eighty percent 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.

U.S. Service Exports Are Growing Rapidly

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 2012, and have more than doubled in the past 10 years. Eighty percent 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.

Good Old American Know-How in Demand

Our top service export, business, professional, and technical services, is a fancy name for good old American know-how. At $153 billion, this would have been our fifth-largest export in 2012. It includes fields ranging from education, oil field services, and entertainment, to advertising, computer and data processing services, and database and other information services, as well as research, development, and testing services.*

This category of exports is basically invisible to average Americans unless they (or someone they know) work in these fields. Nearly 19 million Americans (16% of overall employment in the United States) are employed in this category of service exports, and, unlike most other measures of employment, this category has completely recovered from the Great Recession. Of course, not all of those 19 million jobs are tied to exports, but a sizable portion is.

*These services also include management consulting and public relations, legal, construction, engineering, architectural, mining, industrial services, installation, maintenance, equipment repair, and other services (including medical services).

Exporting Hollywood

Another service export category that stands out is royalties, license fees, copyrights, and broadcast rights, with $124 billion of exports in 2012 [Figure 3]. This includes fees earned by U.S. television networks and movie studios selling licenses to foreign media outlets for overseas broadcasts of TV shows like *CSI, Family Guy, Jersey Shore, Law and Order, The Big Bang Theory, ICarly* and, of course, the Super Bowl, and movies like *Iron Man 3, Despicable Me, Monsters University,* and *Fast and Furious*. It also includes U.S. firms like Microsoft, Apple, Oracle, and Cisco licensing their software for use overseas. Similarly, U.S. companies garnered $43 billion in fees in 2012 by selling their patented manufacturing processes to overseas firms. Financial services (investment banking, advisory fees, trading, trust, custody, etc.) provided by Wall Street investment banks and other large commercial banks netted $76 billion in fees in 2012.

The United States is still one of the world's largest exporters of goods and services, and our fastest-growing exports (services) aren't always as visible as some of the items we import and consume every day.

Foreigners who visited the United States in 2012 spent a whopping $126 billion on hotels, rental cars, and other goods and services while they were here, far outstripping the $83 billion American travelers spent abroad. Looking at combined goods and services export categories, travel would rank sixth. We also ran a huge trade surplus in education, where foreign students spent $25 billion in 2012 to study in the United States, while U.S. students spend just $6 billion to study at overseas colleges and universities.

With the exception of insurance services and freight and port services, the United States enjoys a trade surplus in every major category of services. Most major service export categories have experienced near 10% growth per year over the past 10 years, driven higher by fast-growing emerging market economies eager to consume good old American know-how, along with American culture (TV, movies, Times Square, Hollywood, and Disney World), and expertise ranging from accounting to software and, of course, our world-renowned colleges and universities. In short, the United States is still one of the world's largest exporters of goods and services, and our fastest-growing exports (services) aren't always as visible as some of the items we import and consume every day.

Looking ahead, our competitive advantage in the service sector, including good old American know-how, should help to continue to drive employment higher in this sector, especially in areas that require advanced skills. Our reliance on exports (and employment) in the less volatile service sector, which continue to be in high demand in fast-growing emerging markets worldwide, should help to promote longer U.S. economic expansions and less dependence on the boom-and-bust inventory cycles that accompany more goods-based export-dependent economies around the world. American "know-how" is our most abundant resource and should continue to make the United States an attractive destination for the world's capital. ■

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

Purchasing Managers' Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

Quantitative easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

Markit is a leading, global financial information services company that provides independent data, valuations and trade processing across all asset classes in order to enhance transparency, reduce risk and improve operational efficiency. The Markit Purchasing Managers' IndexT (PMIT) is a composite index based on five of the individual indexes with the following weights: New Orders - 0.3, Output - 0.25, Employment - 0.2, Suppliers' Delivery Times - 0.15, Stocks of Items Purchased - 0.1, with the Delivery Times Index inverted so that it moves in a comparable direction.

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