Selling Our Services to the World (With an Ode to Chicago)

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By Richard W. Fisher

Thank you, Charlie [Evans, president and CEO of the Federal Reserve Bank of Chicago]. And thank you, Mike Moskow for inviting me to speak to the Chicago Council. We miss you, Mike. For 13 years you brought not only wisdom but élan to that big mahogany table at the Fed, and none of us can quite fill that gap. The measure of a successful leader, however, is who he picks as his replacement, and with Charlie, you hit a home run.

I especially appreciate Charlie's mentioning my modest book collection. Part of that collection consists of documents and writings of British prime ministers. One of my favorites is Gladstone. He used to say that "only love has made more fools of men than contemplating the nature of money." Yet, that is precisely what Charlie Evans and I and Ben Bernanke and our colleagues at the Federal Reserve do: We spend practically every waking hour contemplating the nature of money and the proper shape and conduct of our monetary system. So if you detect an air of distraction in Charlie Evans now and then, be kind. He has not gone mad or foolish on us; he is just hard at work noodling through our predicament and conjuring up Chicago's recommendations on what we at the Federal Open Market Committee should do.

Last week in San Antonio, I provided my perspective on the situation we now encounter in a marketplace entering the early stages of recovery from a period of excess, indiscriminate behavior and historical (and occasionally hysterical) amnesia, and on the efforts we at the Federal Reserve are making to calmly and prudently restore the efficacy of the financial markets. I said then—and I assert again today—that there is nothing "unprecedented" about the situation we find ourselves in. To illustrate the point, I want to read a passage from Washington Irving's 1819 essay on the Mississippi Bubble.[1] For those of you who think the recent housing bubble and the ensuing financial imbroglio are "unprecedented," listen to these words penned almost 200 years ago:

> "Every now and then the world is visited by one of these delusive seasons, when the 'credit system'…expands to full luxuriance: everybody trusts everybody; a bad debt is a thing unheard of; the broad way to certain and sudden wealth lies plain and open…. Banks…become so many mints to coin words into cash; and as the supply of words is inexhaustible, it may readily be supposed what a vast amount of promissory capital is soon in circulation…. Nothing is heard but gigantic operations in trade; great purchases and sales of real property, and immense sums made at every transfer. All, to be sure, as yet exists in promise; but the believer in promises calculates the aggregate as solid capital….
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> "Now is the time for speculative and dreaming or designing men. They relate their dreams and projects to the ignorant and credulous, [and] dazzle them with golden visions…. The example of one stimulates another; speculation rises on speculation; bubble rises on bubble…. No 'operation' is thought worthy of attention, that does not double or treble the investment…. Could this delusion

> always last, the life of a merchant would indeed be a golden dream; but it is as short as it is brilliant."

And to think, Washington Irving had never met a subprime mortgage, or a CDO, a CLO, an SIV or a credit default swap! It is indeed true that those who ignore history are condemned to repeat it. That is the bad news. Financiers, "dazzle[ing] the credulous," including regulators, repeated history in spades, despite their claim to unprecedentedly clever and new risk-management tools and mathematical sophistication. It was as short as it was momentarily "brilliant." But that is done, and now we must do what we can to remedy the situation. One thing, however, is clear. The answer, to be curt, is not to compound the bad by repeating the oft-prescribed remedy of inflating our way out of our predicament with a wing-and-a-prayer promise that it can always be reined in later. It is for this reason that I have maintained a strong reluctance to further general monetary accommodation. At the same time, I have been an advocate of using our various discount window facilities, within reason, to bridge the financial system's structural problems as the credit markets correct themselves and run the long course of contrition.

Enough of that pleasantry. That is not what I came to speak about today. I don't know about you, but I am weary of the woeful stuff that is constantly blaring from our newspapers and television sets and the Net, compounded as it is in the throes of a presidential election. Today, I would like to talk about something more uplifting—about the good news documented in another of my favorite books, the Dallas Fed's annual report, which we have placed on each of your chairs and will be releasing to the public after this luncheon.

I hail from one of those growing, prosperous Sunbelt cities that has burst forth as a center of U.S. economic growth in the past generation or two. Dallas is now the hub of the nation's sixth largest metropolitan area, which joins the fifth largest metropolitan area in Houston and the ninth largest in the San Antonio–Austin region to form the economic backbone of a thriving state powered by the gumption of 24 million hard-working, hardscrabble souls. To be sure, our economy is lubricated by a robust energy industry. But it percolates on technology and information. I believe that my hometown of Dallas can serve as a microcosm for our nation's tectonic shift from producing goods to producing services.

By Chicago standards, we Texans may be nouveau riche. But as my father used to say, "It is better to be nouveaux riche than not riche at all." Lest you forget, back at the end of the 19th century, when Dallas and Houston and San Antonio and Austin were just a twinkle in our ancestors' eyes, Chicago was considered equally nouveaux and brash by the folks in New York. It was that brashness that transformed Chicago from what Carl Sandburg described as "hog butcher for the world, tool maker, stacker of wheat, player with railroads and the nation's freight handler" into one of the great cities and a cutting- edge center of finance- and information-based progress. You have repeatedly used your riches to evolve your economy, setting an example not just for Dallas but for all of America.

With each passing year, the U.S. economy relies less on the production of agricultural and factory goods and more on services to fulfill the American Dream. Today, four-fifths of our jobs are in services, a sprawling and diverse sector that includes janitors and cashiers and fast-food cooks, as well as bank presidents and college professors, software "geeks," architects and filmmakers, chemical engineers and bioengineers, doctors and their nemeses, lawyers. Imagine this: In 2005, there were more or less the same number of people employed in the legal services profession as there were in the auto manufacturing sector, yet lawyers contributed twice as much of the value added to our GDP as the automobile manufacturers. We are a service-sector-driven economy, plain and simple.

In 1950, the height of America's Industrial Age, Chicago had 42 percent of its workforce in manufacturing, mining and construction, a share significantly above the rest of the country. Today, industry as we knew it then accounts for just 17 percent of the Windy City's job base, a number below the national average. The remaining 83 percent are in services, putting the city slightly above the national average.

With this remarkable shift from industry to services, Chicago's economy has continued to grow, on net adding nearly 400,000 jobs in the past quarter century. A great many of them are high-paying service-sector positions, putting Chicago 11th among the nation's 280 metropolitan areas in household income. That's in the top 4 percent.

The more adaptable cities are—the more able and willing to remake their economies as times change—the better they do. In his 1916 poem, Sandburg portrayed the raw energy of an emerging industrial giant that was constantly building, breaking up and rebuilding. The economic way of life that defined that era of furious industrial activity may be ebbing or even lost to new industrial sites in China or Eastern Europe, but the fierce desire to keep moving forward has survived and, with it, Chicago's claim to being a vibrant, top-ranking world city.

Old Chicago, perhaps better than young Dallas or the other new cities of the Sunbelt, provides a perfect template for success in today's era of globalization. The United States, like Chicago, can continue to prosper only if it faces economic change head-on, choosing to compete rather than retreat, seeking out new opportunities in a globalizing economy, where goods, services, money and ideas flow freely across international borders.

One of these opportunities—maybe the best one—lies in exporting services. The Dallas Fed explores this subject in its keynote essay in this year's annual report, titled "Opportunity Knocks: Selling Our Services to the World."[2] I urge each of you to read it. Apart from making you feel a bit better about this country's economic future in a globalized and highly competitive world, it might give you some insight into which service industries are likely to outperform others as global demand expands, and why.

Let me take you inside our report, starting with a look into the typical buying patterns of consumers—be they Americans, Chinese or South Africans. Data from nearly all parts of the world show us that consumers tend to spend relatively less on goods and more on services as their incomes rise. You might think of a shopping list. At the top of it are life's necessities, led by the traditional triumvirate of food, clothing and shelter, followed by all sorts of household items, from knives and forks to furniture and appliances, and so on. These are largely goods. Once people have met their basic needs, they tend to want medical care, transportation and communication, information, recreation, entertainment, financial and legal advice, and the like. In short, with increasing prosperity, consumers shift to spending a higher percentage of their money on services. Many services, of course, are customized and delivered directly to clients; they are largely knowledge and information. In the Internet age, this intellectual output can be carved up into bits and bytes and sent nearly anywhere on this planet in a few seconds for a few pennies.

In the United States, we shifted our buying from goods to services as we grew richer. Other rich countries have done the same. There is no reason to believe that the next group of countries climbing the income ladder will behave any differently. That brings us to China and India, two populous nations that in the past decade have stirred from a long slumber and taken off on fast-growth paths. As they've opened up to the rest of the world, 2.5 billion consumers have been added to the world economy.

Many commentators portray the emergence of China and India as a threat. We hear about a flood of Chinese manufactured goods costing U.S. factory jobs. We hear about the outsourcing of jobs to India eroding U.S. service industries. These are actual phenomena. But it is also true—and this we rarely hear about—that these and other emerging countries are not just selling to world markets, they are buying from them, too. Imports as a share of China's economy more than doubled in the past decade to 33 percent. India's import share has tripled to 23 percent.

To a Dallasite or a Chicagoan, that is the sound of opportunity knocking. Let me give you a few examples. At forecasted growth rates, we calculate that China will add $116 billion to world demand for medical care in just one year. India will contribute an additional $25 billion. Together, the incremental demand for medical care from just these two markets will be more than four times larger than the contribution from the U.S. Turning to global spending on recreational services, one year's added demand comes to $79 billion from China and $16 billion from India, compared with $23 billion from the U.S. Down the line, these gains should be even bigger, provided China and India continue to grow their economies.

Now throw in all the services beyond medical care and recreation. Then consider the world beyond China and India, a mix of emerging nations and traditional markets, most seeing their incomes rise. This is new business. Their domestic producers will meet a good chunk of the added demand, but China, India and other countries will shop the globe for what they cannot find at home or what is better elsewhere. Here, we have advantages in many areas. Medicine, finance, education, legal services, forensics, architecture and design, engineering technology, film and other aspects of entertainment—in these service areas and more, America is second to none.

To be sure, we must compete with the Brits, the Europeans, the Japanese, the Aussies and everyone else for this business. But U.S. firms have already proven to be stellar at selling their services to the world. We already export more services than any other nation—by a long shot. Our foreign sales of nearly $500 billion in 2007 exceeded the combined total of the next two services exporters, Britain and Germany. Better still, most of what we sell abroad are highly valued services—and the numbers prove it.

The Bureau of Economic Analysis divvies up services exports into 20 categories. In three-fourths of them, U.S. exports exceed imports. Our edge is nearly 24 to 1 in industrial engineering, which includes American technicians who install computerized control systems, design industrial robots and streamline supply chains. Marquees all over the world tout our movies, and we have a 13-to-1 trade ratio in the distribution of films and television shows. We are crackerjack suppliers of construction services, information management, legal and financial services, and education. Because of our deep reservoir of copyrights and patents, what we receive from foreigners in licensing fees and royalties exceeds what we pay to other countries by better than 2 to 1.

All told, our service exports exceed imports in 15 of 20 categories. In 10 categories, our service exports are more than double our imports—some exceeding even 10 times as much, such as medical services, TV and film, and industrial engineering. In only two service categories are our imports more than double our exports—freight and insurance.

The United States developed its services prowess here at home. Our companies learned how to deliver services efficiently and effectively by meeting the needs of a highly sophisticated, evolving domestic economy. To fill the ranks of these companies, our colleges and universities educated doctors, lawyers, architects and managers. The next logical step has always been to sell this expertise to foreign customers.

We should not overlook the revolution in communications and information technology that has spread around the world in the past two decades, a revolution that was conceived and delivered and nurtured to maturity in the laboratories and universities of the United States. The economics textbooks I had in college told me it was far easier to export goods than services. Physical things could be mass produced, crated, put on ships, warehoused and sold abroad. Most services, in contrast, had to be delivered directly to clients. They faced obstacles in export markets largely because of technological limitations and the high costs involved with communications, travel and information transmittal.

These barriers to services trade have been crumbling. The story goes back to the late 1960s, with the Defense Department's project for decentralizing communications, which a few decades later grew into the Internet we know today. In the mid-1970s, the two Steves—Jobs and Wozniak—sold their first Apple I, the first step toward the desktops and laptops that keep today's businesses humming. Information Age technology expands the range of services that can be delivered over great distances. It makes it cheaper and easier to find and interact with customers overseas.

The upshot is changing trading patterns. The growth rate for U.S. exports was faster for goods than services until the early 1980s. Then, foreign sales of services began rising faster than goods. Since 1985, our services exports have grown nearly 260 percent, eclipsing the 200 percent growth in goods exports. Today, services represent nearly 30 percent of our overseas sales.

We can expect our trade to continue its transition from goods to services. I assure you this is indeed good news, particularly welcome at a time of widespread anxiety about creating good jobs and maintaining high and growing median income levels. Exporting more services will help us do both.

Too often, services get a bad rap. The hamburger-flipper stereotype of services jobs would have us believe that they are innately and unalterably inferior to goods-producing jobs. That simply is not true. Yes, there are low-paying jobs in services, just as there are low-paying ones in goods, but the average services worker today makes more than the average factory worker. If we look back to 1990, we see that hourly wages have grown faster in services than manufacturing for all service categories except transportation and warehousing.

Average manufacturing earnings stood at $16.40 an hour in 2007, excluding overtime. Finance, insurance and real estate workers earned $19.66 an hour. Professional and business services were at $20.14 an hour and information services at $23.92 an hour. Utilities paid their workers $27.93. Only retail trade and leisure and hospitality paid significantly less than manufacturing in 2007—

and these are industries that for the most part don't require advanced skills and employ large numbers of students and many young people just starting their careers.

Productivity determines pay. And America's services workers are among the world's most productive, with an average worker's output at $80,000. U.S. services providers are productive because they're well educated and highly skilled. The capital of our times is human, not mechanical. Yesterday's factory workers brought strong backs, steady eyes and sure hands to the production process, while the capitalist provided the buildings and machinery. Today's service companies may provide office space and computers, but the workers create value with their minds. The engine of the knowledge economy can be found not in sooty factories but atop our necks: It is the human brain. This is particularly true of the services we export, which skew toward the highly sophisticated output of well-educated and skilled workers.

Economic theory tells us that nations will export what can be produced by factors they have in relative abundance. This is the principle of comparative advantage. Countries with significant mineral wealth will sell oil or copper. Those with large tracts of fertile land will sell wheat, corn or beef. Those with cheap labor and large stocks of machinery—think China—will sell run-of-the-mill factory goods. America's highly knowledgeable and experienced services workers are our nation's relatively abundant factor. That is what we sell to the world. That is where our future lies.

Another of my favorite prime ministers was Winston Churchill. In the early years of the 20th century, Britain had a donnybrook of a debate—with Churchill and his free traders pitted against Joseph Chamberlain and the protectionists. Churchill saw how global competition would push a nation to make higher value-added products. Here is how he put it: "The country in which the superfine processes are performed—in which the superfine, the most complicated terminal stages of manufacture are performed—is the country which possesses what may be called commercial 'leadership.' " Today, I would broaden Churchill's words to emphasize services and find commercial leadership in nations, like ours, that possess the talents and experience needed to provide the highest-valued services.

The answer to competition from the new countries that have joined the capitalist race is not to wrap ourselves in the toxic, defensive mantle of protectionism. That is akin to embracing inflation as a remedy to the credit market correction. The answer is to go on the offensive, to master and dominate the "superfine processes." We must continue climbing the value-added ladder into the most profitable and productive services. We must exploit this competitive advantage, so we can continue growing our economy and expanding the welfare of our citizens.

We in Dallas, like you here in Chicago, are working diligently to sell our services to the rest of the world. Progressive cities all over this great country are making yet another sweeping transition—this time, to thinking and acting globally in the services arena—that promises to pave a path that will allow us to remain the world's premier economy for many, many years to come.

Charlie, let me conclude by going back to my books and quoting another Charlie—Charles Eliot, who was Harvard's president for 40 years. He once said, "Books are the quietest and most constant of friends; they are the most accessible and wisest of counselors and the most patient of teachers." I hope that in the essay you will find in the little, accessible book that is our annual report some wise counsel and a quiet but reassuring ray of sunshine for this otherwise dark and impatient world.

Thank you.

NOTES

[1] Washington Irving, "A Time of Unexampled Prosperity," *The Crayon Papers: The Great Mississippi Bubble* (1819–1820).

[2] W. Michael Cox and Richard Alm, "Opportunity Knocks: Selling Our Services to the World," Federal Reserve Bank of Dallas 2007 Annual Report, April 2008. Mr. Cox and Mr. Alm contributed significantly to the drafting of this speech.