

Is the U.S. Well-served by its New-style Economy?

By Fritz Meyer, Senior Investment Officer, A I M Advisors, Inc.

My job involves speaking to ordinary Americans about the U.S. economy. In my mind, it's a very positive story, both looking in the rearview mirror and looking ahead. But, after almost every presentation I give, someone asks a question about the decline of U.S. manufacturing, with the assumption that the U.S. is "going down the tubes" as we've transitioned to a service economy. This article addresses those concerns.

One of the most iconic images of American ingenuity is that of the Model T Ford rolling off a Detroit assembly line in the early 1900s. One hundred years later, manufacturing is no longer the main driver of the U.S. economy—we have switched gears and become a “service economy.” The goods we produce have taken a backseat to the services we provide.

This shift is upsetting to many people, especially folks who were part of the workforce during the country's manufacturing heyday. In their minds, producing goods is the best—if not only—way to create real wealth. How can our economy prosper if we can't hold its output in our hands? These concerned people are often reluctant to invest in an economy they don't understand.

I believe the U.S. is well served by its new-style economy. In my work as an economist, I have found that people's fears are largely based on inaccuracies. Once they understand the facts, they are apt to be a lot more optimistic about our economic and investing future.

Fact #1: The U.S. is still a manufacturing powerhouse.

Manufacturing's presence in our economy has definitely gotten smaller. At the end of World War II, 38% of America's non-farm labor force was employed in manufacturing. Today, that figure is 11%. In 1950, manufacturing accounted for 26% of U.S. gross domestic product (GDP). Today, it's 12%.

But that's not the whole story:

- While manufacturing has declined as a percentage of total employment and GDP, real manufacturing output has grown—at a recent year-over-year rate of 4.4%,¹ and at a 10-year annualized rate of 3.7%.
- On a “value-added” basis, the U.S. is still the world's largest manufacturer. Our share of total value-added global manufacturing has slipped only about one percentage point in more than two decades. (The value-added measurement calculates the dollar value created when materials and labor are melded into finished products.)²

What does this mean? Productivity gains have led to more production of better goods with steadily fewer people. But instead of heading to the unemployment line—U.S. unemployment is running at just 4.7%—workers have found jobs in the growing service fields. Simply put, U.S. manufacturing power has not stalled. Services have just picked up speed.

Fact #2: Service jobs are often good jobs.

Some people may equate the term “services” with lesser skilled, low-paying jobs, and that perception may contribute to their concerns about a service-based economy. But the government simply uses the word “services” to describe everything other than manufacturing. The services category includes not only the cashier at your local fast-food restaurant, but the surgeon who installs artificial knees and the financial advisor who crafts clients’ investment plans.

When I think about the relative decline in American manufacturing jobs during the last 50 years, I think about my dad, who employed a dozen people manufacturing copper wire coils during World War II.

Back then, all 12 of his employees were needed to run the plant. But today, the entire production of my dad’s team could likely be accomplished by one automated, computer-controlled machine. So, what might his employees be doing in today’s world? One person would still be needed to mind the machine (and a dozen more like it) while my dad did the selling, ordering, billing and collecting. That’s just two people running the business.

Would the others be out on the street? I doubt it—not with a 4.7% unemployment rate. My dad’s secretary might be a Web-page designer today. The guy who stoked the building’s coal-fired boiler and kept the place going might be in charge of facilities maintenance at an office complex. True, one of those employees might have a low-paying fast-food job, but another might be a McDonald’s store manager. Others might be employed as a home health aide, an emergency medical technician, a customer service representative or a claims adjuster.

What do you notice about these service jobs? Most of them didn’t exist in my dad’s day. And, on average, they pay approximately the same hourly wage as today’s average manufacturing job.³

Fact #3: Our service economy has created wealth.

What does it really mean for us that our economy is based on these jobs? If Americans aren’t mainly *producing* things that we can see, touch, hold or drive, are we really growing our wealth as a nation?

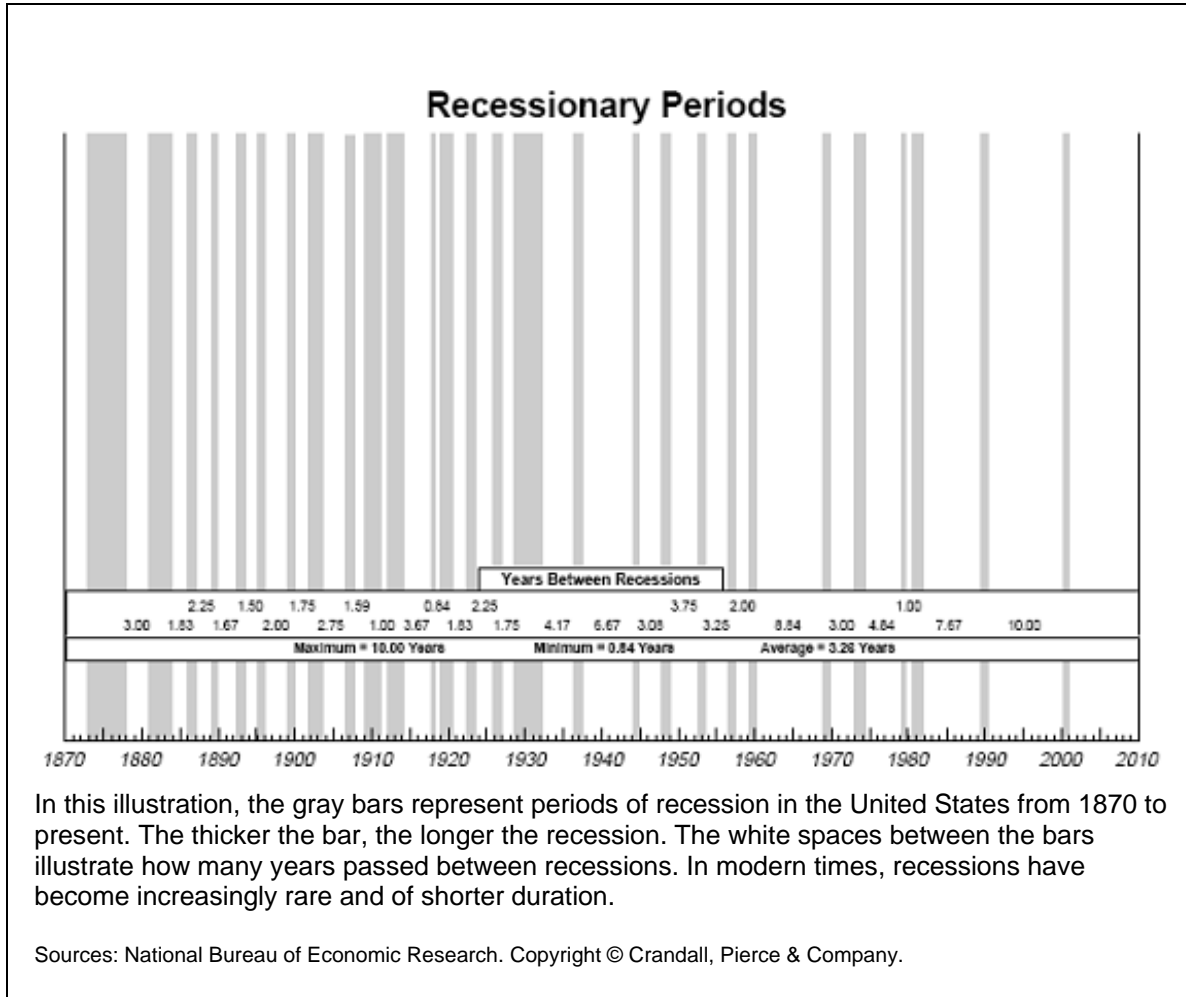
I’ll answer that question with another illustration. During World War II, my parents owned a home, a summer house and two cars. However, it was a treat to eat out or go to a movie, and vacations were taken within driving distance.

Today, my wife and I have raised our family in a house the size of my parents’, and our possessions are not much more than theirs were. But, we are far richer than my parents’ generation. Not because we have more “stuff,” but because we have the capacity to purchase a vast array of services—many of which didn’t even exist in my parents’ day.

Our children attended daycare. We travel by airplane and stay in hotels. We’re regular customers at Starbucks and eat in restaurants at will. We exercise at a facility staffed with professionals, purchase entertainment in myriad forms, and buy legal and financial advice. We expected our children to be taught by quality professors. We buy modern miracle drugs and have laser eye surgeries that enhance the quality of our lives. We’re planning for cruises in retirement and, ultimately, some assisted living in our decrepit years. *This* is the modern definition of wealth.

The benefits of a service economy.

In my opinion, America’s transformation to a “service” economy has been hugely beneficial. Recessions have become increasingly rare and of shorter duration. From 1869 to the start of World War II, the U.S. was in recession more than 40% of the time.⁴ In the last 25 years, that figure is less than 9%.



Bottom line: The steady decline of manufacturing and agriculture in proportion to total economic output is largely responsible for steadier, more predictable growth.

As a result, Americans’ standard of living—real purchasing power—has risen decade upon decade. Among the 30 developed nations that belong to the Organization for Economic Cooperation and Development (OECD), there is only one—Luxembourg—that has greater GDP per capita than the United States. Even wealthy Switzerland produces just 85% of what we do. On average, the 30 OECD nations produce just 70% of U.S. GDP per capita, and Europe’s GDP per capita relative to the U.S.’s has been trending lower since 1982.⁵

Yes, this is progress as I see it. The process of change will keep racing ahead—and we Americans will all be better off for it.

1. Federal Reserve Statistical Release, March 17, 2006.
2. "If You Can Make It Here," *New York Times*, September 4, 2005.
3. U.S. Census Bureau, Statistical Abstract of the United States: 2006, Table 628.
4. "Worst Is Over: Recessions Are Self-Correcting In Modern Era," *Investor's Business Daily*, January 9, 2002.
5. OECD, "Productivity Levels and GDP per Capita," September 2005.

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