

Globalization of the Industrial Production Chains and Measuring International Trade in Value Added – Speech by **Pascal Lamy**, 15 Oct 2010

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Representatives of the Government and Institutions of the French Republic,
Ambassadors and representatives of WTO Members and Observers,
Esteemed experts,
Ladies and Gentlemen

It is a great honour for me to be here among you today to open, together with my friend Jean Arthuis, this conference on a subject that is particularly close to my heart.

It must be fairly unusual for the Senate to host, within its ornamental walls, a statistical seminar. But that we should meet here to examine the statistical aspects of the measurement of foreign trade in the light of the new challenges brought about by globalization is an all-time first, and I am grateful to the Senate for realizing the importance of the subject. The challenge is not only for statisticians, but also, and above all, for the decision makers responsible for ensuring the proper conduct of domestic and international policy.

Public affairs and official statistics have long been good bedfellows. The original idea was to draw up an inventory of the Prince's wealth in an essentially agrarian economy. Statistical production has evolved according to need in an economy that became increasingly complex following the industrial revolution and the advent of the service society the intangible products of human activity that are a headache not only for statisticians, but also for trade negotiators. But national accounts continue to be based on the idea of an inventory of what is "ours" and what is "theirs" (in technical language, the notion of "resident" and "non resident" in establishing the country's balance sheet, its balance of payments).

When the needs of economic and social policy change, statistics must follow along, and better late than never. It took the 1929 crisis for national accounting, invented by the Physiocrats in the 18th Century, to take over, after the second world war, as the main economic frame of reference for both decision makers and statisticians. As a result, analysts had better statistical tools for testing their theories and coming up with new theories: while analytical progress leads the way for statistics, it is statistics, in their turn, that correct and alter our perception of economic and social phenomena, enabling theory to put forward new interpretations.

It may not be a coincidence that the recent global crisis, unprecedented in its intensity since the Great Depression, revived analysts' interest in improving the statistical instruments on which States rely in analysing economic trends and determining what policies to adopt. The fact that statistics rely on analytical progress to improve their figures and that political decision makers use them to guide their choices enhances the public debate. More often than not, these statistical improvements take place

progressively thanks to greater conceptual precision, to increased efficiency in the methods used, and to added efforts to produce data.

In approaching the matter that brings us together here today, what we will be doing is taking a quantum leap and examining, from a different angle, two of the underlying concepts of international trade and balance of payments statistics, namely the notion of country of origin, and the concept of resident as opposed to non resident.

In the 19th Century, when Ricardo developed what was to become the foundations of international trade theory, countries exported what they produced. In fact, the industrial revolution took root in countries that had coal mines and iron ore. A Portuguese entrepreneur importing a steam engine from England would know that everything from the steel of the wheels to the boiler pressure gauge came from the United Kingdom. Similarly, an English club importing Port wine for its members could be sure that it came from Portugal.

Today, Port wine is still of Portuguese origin. Thanks to progress on registered designations of origin, the English importer today is in fact more certain of this than his 19th Century counterpart. However, the concept of country of origin for manufactured goods has gradually become obsolete as the various operations, from the design of the product to the manufacture of the components, assembly and marketing have spread across the world, creating international production chains. Nowadays, more and more products are “Made in the World” rather than “Made in the UK” or “Made in France”.

Most likely “Made in China”, you might add!

This is what many people today mistakenly believe. What we call “Made in China” is indeed assembled in China, but what makes up the commercial value of the product comes from the numerous countries that preceded its assembly in China in the global value chain, from its design to the manufacture of the different components and the organization of the logistical support to the chain as a whole. In other words, the production of goods and services can no longer be considered “monolocated”, but rather, “multilocated”. As a result, the notion of “relocation”, which made sense in the past when referring to the production of a product or service at a single location, loses much of its meaning. If I relocate a segment of the production chain for reasons of economies of scale, and others relocate to my area for the same reasons, the impact on my total value added, i.e. roughly speaking, my employment, may be neutral, negative or positive; and nowadays, it is this balance that we have to look at very closely. If we continue, in this context, to base our economic policy decisions on incomplete statistics, our analyses could be flawed and lead us to the wrong solutions.

For instance, every time an iPod is imported to the United States, the totality of its declared customs value (150 dollars) is ascribed as if it were an import from China, contributing a bit more to the trade imbalance between the two countries. But if we look at the national origin of the added value incorporated in the final product, we note that a significant share corresponds to reimportation by the US, and the rest to the bilateral

balance with Japan or Korea which should be allocated according to their contribution to that added value. In fact, according to American researchers, less than 10 of the 150 dollars actually come from China, and all the rest is just re exportation. In the circumstances, a re evaluation of the yuan — a topic which is very much in vogue these days — would only have a modest impact on the sales price of the final product and would probably not restore the competitiveness of competing products manufactured elsewhere.

Similarly, the statistical bias created by attributing the full commercial value to the last country of origin can pervert the political debate on the origin of the imbalances and lead to misguided, and hence counter-productive, decisions. Reverting to the symbolic case of the bilateral deficit between China and the United States, a series of estimates based on true domestic content cuts the deficit by half, if not more.

This impression is confirmed by other figures, if we accept to “debilateralize” them: if we look at the US trade deficit with Asia rather than its bilateral deficit with China, we note a remarkable stability over the past 25 years at something like 2 to 3 per cent of the United States’ GDP.

As for the impact on employment — understandably a rather sensitive issue in these times of economic crisis — once again the result can be surprising. Reverting to the case of the iPod, another study by the same authors estimates that on a global scale, its manufacture accounted for 41,000 jobs in 2006 of which 14,000 were located in the United States, 6,000 of them professional posts. Since American workers are more qualified and better paid, they earned more than 750 million dollars, while only 320 million less than half — went to workers abroad.

In this example, case studies have shown that the innovating country earns most of the profits; but traditional statistics tend to focus on the last link of the chain, the one which ultimately earns the least. Don’t get me wrong, I am not saying that this is always the case and that relocations always create more jobs than they destroy. You will probably have the opportunity to discuss the matter here.

But I simply wanted to highlight the paradoxes and the misunderstandings that arise when new phenomena are measured using old methods. Statistical survey experts know very well that “if you ask the wrong person, you will get the wrong answer”. Similarly, if you analyse a phenomenon using the wrong “measurements”, you will reach the wrong conclusions.

As pointed out in a study published in 2009 by the Senate on the measurement of France’s foreign trade, “traditional measurement of foreign trade alone no longer suffices to explain how [the country] fits into the world economy”. In other words, the time has come to explore new channels so that accounting and statistical systems can take account of the new geography of international trade in an economy which, in the words of the American Tom Friedman, has flattened under the influence of globalization and internationalization of production relations. In today’s world, the old mercantilist notion

of “us” against “them”, of “resident” against “rest of world”, has lost much of its meaning.

However, to avoid any misunderstandings on the WTO’s objectives in this new area of research, I would like to say to the statisticians here today that we are certainly not “deconstructing” the national and international statistical system or “displacing” certain elements of that system. On the contrary, we are trying to “relocate” and “reorganize” in a more integrated context the sparse information available today in different and separate subsectors of the existing systems. Although it is true that today, the notion of resident/non resident has lost some of its relevance when it comes to understanding the microeconomic reality of world value chains, the fact remains that it is the concept of national territory that counts when it comes to public policy. Similarly, national accounts must remain the unifying framework for the different statistical subsystems.

The challenge, then, is to find the right statistical bridges between the different national accounting systems in order to ensure that international interactions resulting from globalization are properly reflected and to facilitate cross border dialogue between national decision makers. This reconstruction work, involving a more structural incorporation of national trade, industrial and employment statistics in a globalized vision, clearly has to rely on reinforced statistical cooperation among multilateral organizations. And I would like to stress, here, the coordinating role that has to be played by organizations like the OECD, Eurostat, the specialized United Nations Agencies and the Monetary Fund — not to mention the WTO — in this revision project.

Let me conclude by thanking, once again, the Senate’s Financial Commission for taking the initiative of organizing this conference, and all of the participants who were willing to share their knowledge and experience with us. We need only consult the speaker’s list to see that the discussions will be on a high scientific and technical level. The reputation for wisdom associated with the discussions of this illustrious institution serves as a guarantee that high quality technical proposals will ultimately fall upon attentive and competent ears.

Finally, I would like to thank the participants who responded to the joint invitation by the Senate and the WTO, in particular the representatives of the permanent missions and observers who travelled from Geneva or from their capitals for this occasion. Their presence here bears testimony to their interest in these discussions that are so crucial to understanding international trade today, and I am certain that your work here in the Senate will help to enlighten our debates in Geneva.