Asia's Developing Future

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The effect of services needs to be updated in economic activity data to avoid bad decisions

The idea that manufacturing is superior to services for powering a country's economy has long been taken as a given.

That's why some economists have issued warnings about developing countries experiencing what they call premature deindustrialization. In those countries, they see service activity overtaking manufacturing before a proper manufacturing economy has taken hold.

But what if the way services are measured no longer reflects modern production? And what if services don't deserve to be relegated to a lesser form of production anyway?

A recent working paper for the Asian Development Bank Institute details the way definitions used to measure manufacturing and services have failed to keep up with reality. It points out that mistakes being made in these measurements have real-world results since they determine decisions being made by governments about their economies.

Economists have known about these problems for some time, but until now they have mostly been dismissed as minor statistical quirks. The working paper argues that they are not minor issues and that they can cause mistakes that will only get worse if they aren't fixed soon.

Services already account for the majority of global production. They were 66% of global GDP in 2016.

Developed countries have steadily been switching from manufacturing into economies dominated by services. That trend is well known and is generally seen as a natural progression as countries get richer.

What has worried some economists is that national accounts, the measure used to calculate a country's economic activity, show that some developing countries have been following the same trend and doing so faster than might have been expected.

Those economists are sounding alarm bells because they think it is too early for developing countries to move out of manufacturing, which is generally seen to be a more productive use of a growing country's workforce.

There are some problems with those assumptions.

The first problem is that the measures of overall manufacturing and services in the economy may be out of whack because of the way manufacturing now works.

In the past, a company would design a product, manufacture it, market it and sell it. It would have an accounting department and people to handle after-sales relationships with clients.

Now, each of those activities can be split off. A company can choose to be involved in as much or as little of the process as it wants. The same process is in place but now the service functions that used to be embedded in the manufacturing have been sliced off. They are counted separately, making it appear that service employment and activity have increased, and manufacturing has decreased. If one then measures productivity (as output per person employed), it will seem as if manufacturing is getting more productive and services less productive!

The process may have become more efficient but all else being equal, nothing has changed in overall production.

Another problem is the way that services are measured. They are measured in national accounts the same way that manufactured goods are measured.

But that misses much of the value of many services.

For example, research may lead to a development in one industry that improves a product for many years, but the production of that research will only be measured once. Production of the good that is improved will be measured throughout the product's life.

Many services by their nature are intangible when compared with goods. It's easy to measure a widget but much harder to measure the services that make that widget possible. What is a communications network worth that allows modern industry to function compared with a machine that stamps out car parts?

In a lot of industries, the very definitions no longer make much sense. When music was sold on compact disc or vinyl records it was classified as goods. Now that it is predominantly sold on streaming sites or through digital downloads, it is classified as a service.

Finally, national accounts miss all the services that are not directly paid for.

Free goods, things like Facebook or Wikipedia that are used by billions of people, are not even measured in national accounts as a 'social media' service (although the income generated from advertisers, for example, will appear elsewhere).

If someone looks after their ailing parent at home that is not counted as a service. If they hire someone to do it, that service is counted.

The value of unpaid care work as a share of GDP has been measured at around 25% to 35% of GDP, with most of the work being performed by women.

The paper points to a better way of measuring goods and services, one that doesn't favor manufacturing over services. It suggests using what is known as time-use surveys to measure production within an economy.

Time-use surveys can be used to measure activities not by what is produced, but by the value of the time taken to produce them.

That way, a more accurate picture of the work being done can be used by those making decisions that affect the economy.

This podcast was based on *The Servicification of Manufacturing in Asia: Redefining the Sources of Labor Productivity*, a working paper for the Asian Development Bank Institute by Valerie Mercer-Blackman, a senior economist at the Asian Development Bank, and Christine Ablaza, a doctoral student at the University of Queensland in Brisbane.

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