‘Made in China’ tells us little about global trade

By Pascal Lamy

As recently as 30 years ago, products were assembled in one country, using inputs from that same country. Measuring trade was thus easy. 2011 is very different. Manufacturing is driven by global supply chains, while most imports should be stamped “made globally”, not “made in China”, or similar. This is not an academic distinction. With trade imbalance causing friction between leading economies, the measures we use can gravely exacerbate geopolitical tensions at a time when co-operation is more vital than ever.

International trade is currently measured in what is known as gross value. The total commercial value of an import is assigned to a single country of origin, as the good reaches customs. This worked fine when economist David Ricardo was alive: 200 years ago Portugal was trading wine “made in Portugal” for English textile “made in England”. But today the concept of country of origin is obsolete. What we call “made in China” is indeed assembled in China, but its commercial value comes from those numerous countries that precede its assembly. It no longer makes sense to think of trade in terms of “them” and “us.”

This is not to suggest that all international trade tensions will vanish overnight if we change the way trade is measured. But if we are to debate something as important as trade imbalances, we should do it on the basis of numbers that reflect reality. A distorted trade picture can inflame bilateral relations, while raising anti-trade sentiment at a time when protectionist pressures are already rising. Economists have long abandoned the view that trade is a zero-sum game, but the day-to-day worlds of politics and markets still seem to work on old mercantilist beliefs. The crisis has naturally exacerbated this feeling, even at a time when global manufacturing has made distinctions between "us" and "them" ever less relevant.

Apple's iPhone illustrates this clearly. It is assembled in China, then exported to the US and elsewhere. Yet the components come from numerous countries. According to a recent Asian Development Bank Institute study, the phone contributed $1.9bn to the US trade deficit with China, using the traditional country of origin concept. But if China's iPhone exports to the US were measured in value added – meaning the value added by China to the components – those exports would come to only $73.5m.

It isn't just phones. Automobiles, aircraft, electronics – even clothing – are increasingly made in many countries. No car or commercial jet could now be built with inputs from just one country. Business leaders also know that new trade frictions are especially damaging in an era of global supply chains. Import duties, red tape or other delays or costs in the delivery of inputs means higher costs. And our traditional trade statistics make such frictions much more likely.
The statistical bias created by attributing commercial value to the last country of origin perverts the true economic dimension of the bilateral trade imbalances. This affects the political debate, and leads to misguided perceptions. Take the bilateral deficit between China and the US. A series of estimates based on true domestic content can cut the overall deficit – which was $252bn in November 2010 – by half, if not more.

Measures we use also change the way trade affects jobs too. Research on Apple's iPod shows that out of the 41,000 jobs its manufacture created in 2006, 14,000 were located in the US. Some 6,000 were professional posts. Yet since US workers are better paid, they earned $750m, while only $320m went to workers abroad. Indeed, the iPod may have never existed if Apple had not known that Asian companies could supply components, while both Asian workers and Asian consumers would manufacture and buy it. Statistics that measure value added can provide a more reliable way of seeing how trade affects employment.

Different means of calculating trade is relevant well beyond the US and China. Thinking about trade in value-added terms can take us beyond the politics of bilateral trade balances. Seen this way, trade shifts from a one-to-one balance into a network of value-added chains, where interdependence dominates and everyone can win. Most importantly, it will help policymakers, and their populations, see the need for stronger multilateral trade co-operation – and the global growth and jobs they can bring.

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