Business Services and the Economic Performance of the New York Metropolitan Region

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As correctly noted by Matthew Drennan in his paper for this conference, the nature of the transformation that has occurred in the New York metropolitan region since 1989 is rather mixed. Although the region has regained only half of the 625,000 jobs it lost during the 1989-92 period, aggregate earnings for the region, in real terms, are higher today than they were in 1989. This discrepancy does indicate steady gains in overall productivity for the metropolitan region as a result of both a continuing change in industry mix (from lower-productivity to higher-productivity industries) and productivity gains within individual industries (resulting from a relative shift from lower skilled to higher skilled work). In addition, data on personal income per capita show a steady long-term gain for the region. This finding reflects the fact that, in addition to achieving steadily growing earnings, the metropolitan area has done rather well in capturing its share of all transfer payments, dividends, interest, and rents that together represent nearly 40 percent of all U.S. income.[1] In short, although the job count may be down, the metropolitan region has certainly not gotten any poorer as a result.

As is also suggested by Drennan (in his Table 2), the sectoral shift that has been under way since the 1960s is a relative shift away from goods production (and ancillary transportation and distribution services) for the export sector toward the production of export-oriented producer services (financial, accounting, legal, engineering, and so forth) and export-oriented medical and educational services. Furthermore, it is this shift that has been largely responsible for the earnings gains noted earlier, in part because most of these service industries pay high salaries and have been shedding relatively low-skilled jobs in favor of higher skilled ones through either relocation or technology.

In the medium term, the critical strategic issue for the metropolitan region is whether these export-oriented services will continue to provide the basis for future growth of the region—if not job growth, at least earnings growth—or whether their vitality might come under threat.

Business Services in the World Economy

I have been asked to comment on the possible future role of business services in the metropolitan economy and will try to do that in light of some work I completed recently for the Organization for Economic Cooperation and Development (OECD).[2]

In 1995, the United States had a surplus of roughly $70 billion for trade in services (compared with a $175 billion deficit for trade in goods). Total service exports were almost $200 billion, of which producer ser-

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vices—as defined in the Drennan paper—represented nearly $35 billion.[3] How big is New York's share of U.S. service exports? To the best of my knowledge, no one knows for sure, but a 20 to 25 percent share of all U.S. service exports is probably a reasonable estimate. In terms of producer services alone, New York's share is likely to be even higher.

Of course, this is only part of the picture. As we know, export of services—including business services—often occurs through offices established in export markets. Hence, transactions initiated in a foreign office may lead to complementary transactions initiated in the home office, with neither ever being counted in the service trade balance.

The question for the future is, What is the likely resilience of New York's producer service firms in the face of competition, not only from firms located elsewhere in the United States but also from firms located abroad?

NEW YORK BUSINESS SERVICE FIRMS

In my OECD study, I was asked to look at both the relative strength of the business service industries in various OECD countries and the possible influence of the regulatory environment of both home and host countries on the financial performance of firms. In general, the analysis confirmed the powerful presence of U.S. firms in fields ranging from accounting and legal services to engineering and architectural services—fields in which New York firms are often also at the top of the U.S. rankings.

In the study, I was able to put together firm-level data files for both the accounting and legal industries for the United States and a number of the largest European countries (the United Kingdom, Germany, France, Italy, and the Netherlands) and examine in more detail the nature of the comparative advantage of U.S. firms. By just about any measure (income per partner, income per professional staff, or income per total staff), U.S. firms tend to be more productive than those based anywhere else in Europe. Although the productivity of U.S. firms' European offices may be somewhat lower than that of the same firms' U.S. offices, it is still typically higher than the productivity of the offices of European competitors. The data show that U.S. firms derive some of that advantage from a more favorable mix of skilled labor (a higher ratio of nonpartner staff to partners than in European firms). In addition, the data strongly suggest that U.S. firms are typically better at shifting their business mix away from lower margin services (such as audit) toward higher margin services (such as consulting), building up a competitive advantage in the form of unique expertise that they use to strengthen their position in foreign markets. This, the study suggests, is partly a reflection of both a more mature and a more competitive U.S. market.

Another source of competitive advantage for U.S. firms is the size of their networks of foreign offices compared with those of their foreign competitors. Typically, U.S. firms have much larger networks. Although the size of networks alone may be a source of diseconomies of scale—because the administrative costs of managing a multiple-office structure are higher than those of managing a single-office structure, everything else being held constant—the size of networks is also a source of significant economies of scope. With a presence in a larger number of countries, U.S. firms can offer clients types of multinational business transactions that others cannot.

In general, the OECD study suggested that the U.S. regulatory environment—typically more mature (that is, more developed) and more competitive—was a significant factor in keeping U.S. firms at the cutting edge of their industry. Of course, the study did not suggest that all was quiet on the competition front. Insofar as I was able to separate out some of my data for New York firms, the study did suggest a significant link between a number of business services and financial sector transactions, showing that some of the subsectors (such as legal services) remain significantly affected by what happens on Wall Street. However, as several papers presented at this conference suggest, employment retrenchment in the financial sector in New York does not necessarily reflect a decline in New York's role as a place where financial transactions are engineered. Whether New York's role as the world's dominant financial center is likely to be challenged by the creation of the Euro remains to be seen. An equally convincing case for a strong or a weak Euro can be made at this particular point in time. In the long run, the strength of the Euro may be partly a function of the strength of the European economies, which at the moment are in a bit of the doldrums.

Another interesting point that was revealed by my study is the increasing competitive pressure of accounting firms on law firms. Although the United States has tended to keep a strong separation between law and accounting, that is not the case elsewhere. Hence, in Western Europe, Eastern Europe, and Asia, the Big 6 accounting firms are already often the largest law firms and are able to provide their lawyers with a formidable comparative advantage (in the form of lawyers posted in many different locations) not available to traditional law partnerships whose networks of foreign offices are typically far smaller. In short, significant changes in the New York legal industries are quite possible in the not-so-distant future.

In sum, I would be willing to predict that producer services will continue to contribute positively to employment and, even more so, to earnings growth in the New York metropolitan region in the years ahead—assuming there is no cyclical downturn looming on the horizon.

ENDNOTES

1. This fact is confirmed by unpublished results of work in progress by Thomas Stanback and Thierry Noyelle related to the authors' updating of their *Economic Transformation of American Cities* (1983).

2. See Noyelle (1995).

3. All figures are from the U.S. Department of Commerce, as cited in Coalition of Service Industries (1996).

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