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Globalization: Threat or Opportunity for the U.S. Economy?

This Economic Letter *is adapted from remarks delivered to the Hawaii Society of Investment Professionals in Honolulu on April 29, 2004.*

As a monetary policymaker, my main concern is the health of the U.S. economy. Although the economy turned in a pretty sluggish performance for a long while after the 2001 recession, it has shown some real strength over the last few quarters in terms of output growth and productivity.

But along the way, the jobs market performance was surprisingly disappointing—at least, until the last few months. This certainly raised concerns—not only for those looking for work, but also for us at the Fed and for other policymakers around the country.

In the discussions about jobs, a lot of attention has focused on trade and terms such as "globalization," "outsourcing," and "offshoring." The concern, of course, is that a free-trade environment is letting good jobs drain from the U.S. economy and wind up in China, India, and other countries where workers command much lower salaries. In the extreme, some would like to see restraints on trade to protect those jobs and halt the globalization trend.

Whether globalization is a threat or an opportunity for the U.S. economy is a big question with serious ramifications. Though I won't be able to cover all the issues, I hope to add a little balance to the discussion. I'll focus on four questions. (1) Why are most economists in favor of free trade? (2) What exactly are "outsourcing" and "offshoring"? (3) Is globalization a threat or an opportunity for the U.S. economy? (4) What can policies do to help U.S. workers?

Why are most economists in favor of free trade?

Basically, the argument is that *everyone* benefits when countries specialize in the type of production at which they're relatively most efficient. Consider this analogy with the family: No family tries to make everything that it eats, wears, and enjoys. If it's cheaper to buy something or have someone else do something, that's what a family does. Then individual family members can concentrate on becoming good at their jobs in order to pay for what they buy.

A nation is no different. If it costs less to make certain products abroad than it does in the U.S., then it's difficult to argue that U.S. consumers and U.S. companies should pay more for those products from U.S. producers. Instead, it makes sense to purchase those products more cheaply from abroad, whether they're hard goods, like VCRs, or services, like call centers. Then we can devote our resources to producing and exporting those goods where we have a relative advantage. The result is a twofold benefit—greater efficiency and lower costs for U.S. firms and consumers.

What are "outsourcing" and "offshoring"?

In its broadest sense, outsourcing is simply contracting out functions that had been done in-house, a longtime U.S. practice. When a car manufacturer in Michigan buys brake pads from an intermediate supplier in Ohio rather than produce them in-house, that's outsourcing. When a company replaces its cleaning and cafeteria workers with an outside contractor who does the same services more cheaply, that's outsourcing. When a company contracts out its payroll, accounting, and software operations, *that's* outsourcing. Clearly, outsourcing can result in job losses if the outside supplier is more efficient and uses fewer workers.

Offshoring has been referred to as the global cousin of outsourcing. Instead of turning to domestic providers, firms may decide to purchase a good or service from overseas providers because of lower costs. Offshoring, too, has a long history in U.S. manufacturing; for example, firms in Mexico supply seat covers and wiper blades to Detroit automakers. What appears to be new about offshoring is that it's affecting workers in the service sector who never expected

to see foreign competition for their jobs—data managers, computer programmers, medical transcriptionists, and the like.

How much offshoring is going on? That's difficult to say. We don't have official statistics, and there are a lot of unsettled measurement issues. But a couple of estimates that have gotten some press recently both suggest that the U.S. lost 100,000–170,000 jobs to foreign workers between 2000 and 2003. Those numbers sound high until you put them in the context of all the job turnover that occurs every year in the U.S. Each year, some 15 million jobs are lost for all kinds of reasons—voluntary employment changes, layoffs, firings, and so on. And in a growing economy, every year even more jobs are created.

Is globalization a threat or an opportunity for the U.S. economy?

The answer to this question will focus on three important issues that are sometimes neglected in the discussion. First, globalization means that economic activity flows in *both* directions; although we may lose jobs to foreign workers, we also may gain jobs and boost economic activity. For example, data suggest that, in terms of office work, the U.S. *insources* far more than it *outsources*; that is, just as U.S. firms use the services of foreigners, foreign firms make even greater use of the services of U.S. residents. "Office work" refers to the category of business, professional, and technical services that includes computer programming, telecommunications, legal services, banking, engineering, management consulting, call centers, data entry, and other private services. In 2003, we bought about $77 billion worth of those services from foreigners, but the value of the services we *sold* to foreigners was far higher, over $130 billion.

Here's another set of interesting numbers. Between 1991 and 2001, U.S.-based multinationals created close to 3 million jobs overseas. But they also created 5½ million jobs inside the U.S.—an increase of about 30% in payrolls. That's a significantly faster rate of job growth than purely domestic companies generated. And it shows that you can't assume that a job created overseas necessarily means one isn't created here. For example, expanding an overseas network frequently means you have to hire more workers in the U.S., too—people in management, logistics, research and development, and international IT.

Here's a final set of numbers. According to the Commerce Department, even as the U.S. "loses" jobs when our companies send operations offshore, we also "gain" jobs as foreign corporations invest here. Specifically, foreign firms employed almost 6½ million workers in the U.S. in 2001—up from about 5 million in 1991; these workers included highly paid Honda and Mercedes-Benz workers in the auto industry. There are plenty of other examples. In 2006, Toyota will employ 2,000 people building cars in San Antonio. Samsung is investing $500 million to expand its semiconductor plant in Austin, Texas. And Novartis is moving its R&D operation from Switzerland to Massachusetts.

My second point is that open trade creates opportunities in the U.S by helping foreign economies become stronger. As incomes grow in other countries, so does their demand for goods and services, many of which those countries will not be able to produce—just as the U.S. does not. This rise in foreign demand for imports is an opportunity for U.S. firms to compete to provide those products. And it would be a shame to miss that opportunity because of trade barriers our policymakers erected. It would mean lost export sales and lost jobs in those sectors.

Finally, globalization can help increase productivity growth in the U.S. The example of offshoring's effect on the spread of IT in the U.S. and, therefore, on our economic growth illustrates the point. According to one estimate, the globalized production of IT hardware—that is, the offshoring of computer-related manufacturing, such as Dell computer factories in China—reduced the prices of computer and telecommunications equipment by 10%–30%. These price declines boosted the spread of IT throughout the U.S. economy and raised both productivity and growth.

Offshoring offers the potential to lower the prices of IT software and services as well. This will promote the further spread of IT—and of new business processes that take advantage of cheap IT. It also will create jobs for U.S. workers to design and implement IT packages for a range of industries and companies. Although some jobs are at risk, the same trends that make offshoring possible are creating new opportunities—and new jobs —throughout the U.S. economy.

I've mentioned productivity several times so far, and I want to focus on it briefly, because I think it plays a significant role in the discussion about jobs in the U.S. Over the past two years, U.S. productivity in the nonfarm business sector has grown at a 4.8% annual rate. In the short term, this increased pro-

ductivity has let businesses satisfy the demand for their output without having to hire new workers on net. So, it appears that this extraordinary surge of increased efficiency in our economy explains much more about the jobs situation than offshoring, outsourcing, or globalization does.

Although, clearly, productivity creates pain for workers who are displaced, most economists agree that higher productivity is a good thing for the economy. Why? Because, in the long run, higher productivity is the only way to create higher standards of living across the economy. The American worker's ability to produce more goods and services per hour has been the key to the U.S. economy's surprising success throughout its history. Consider the manufacturing and agricultural sectors, where more output can now be produced with fewer workers. The same trend has occurred in services: the U.S. used to have lots of elevator operators, telephone operators, bank tellers, and gas station attendants, but now technological advances have taken over many of these jobs. Likewise, the Internet has taken over many routine tasks from travel agents, stock brokers, and accountants. And, with high-speed data links, a lot of office work can be done more cheaply abroad.

What happens to the displaced workers? They move into other sectors of the economy as new jobs emerge. For example, by one estimate, about a quarter of today's labor force is in jobs that didn't even exist in 1967.

This emergence of new jobs and workers' ability to move into them are the hallmarks of a flexible economy—that is, an economy in which labor and capital resources move freely among firms and industries. And such flexibility is a significant strength of the U.S. economy. We operate in competitive markets, and competition, whether from domestic or foreign competitors, induces change. To adapt to that change, and to ease the burden of adjusting to it, flexible labor and capital markets are critically important.

What can policies do to help U.S. workers?

In terms of the overall economy, appropriate monetary and fiscal policies can ensure that aggregate demand keeps the economy on a sound footing, which helps generate jobs to replace those that have been lost.

But words about aggregate demand can seem like cold comfort to the individual workers whose offices and plants are closing because their jobs are going overseas. And concern for these workers, of course, is why there's interest in trying to restrict trade with tariffs, quotas, or other barriers. Indeed, such measures may actually succeed in slowing job losses in affected industries temporarily. But, as I hope I've illustrated, in the end, they impose significant costs on the rest of the economy that are much higher than any benefits.

That's why I believe it's far more appropriate to have policies that focus on protecting the *people* at risk, not the jobs. Such policies should aim to do two things during difficult transitions: help workers get through the hard times and help workers become more flexible so they can adapt when they do face these kinds of changes. In fact, we have policies like these—unemployment insurance, for example. We even have policies specifically for manufacturing workers who have lost jobs to foreign competition. These trade-adjustment assistance programs offer both financial support for a time and the opportunity for training, so that workers can retool their skills and find new jobs. So, in order to help the *service* workers who have lost their jobs because of outsourcing, it might be appropriate to extend these programs to them.

I realize there's some debate about how effective the programs are, but the concepts they're built on are, to my mind, right on target—giving workers a safety net and giving workers the training and tools to qualify for the jobs being created in the U.S. In fact, such programs also could be appropriate for workers who have lost jobs in the wake of the technology-driven productivity surge.

In the long-run, of course, the solution is simple to state, but difficult—and costly—to implement. And that solution is improving the performance of the U.S. education system. Education is the bedrock of our current edge in technology and productivity. It's the key to producing workers with the flexibility to learn new skills as market conditions evolve. And it's the hope and promise we must provide for future generations of Americans.

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