

Offshore Outsourcing Finds Fans at Fed Forum

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JACKSON HOLE, Wyo. -- Globalization, the conventional wisdom goes, has downsides: It hurts the wages of the lesser skilled. It leads to large and possibly dangerous trade imbalances. It can threaten economic stability through financial-market volatility.

But academics, investment bankers and government officials at the Federal Reserve's annual symposium here heard a much more upbeat vision of a globally integrated world. For example, it is usually said that outsourcing work from a high-wage country, such as the U.S., to lower-wage ones -- also dubbed "offshoring" -- makes workers in the richer country's affected industries worse off, but the country as a whole better off, because consumers enjoy lower prices on the products made overseas. But Gene Grossman and Esteban Rossi-Hansberg of Princeton University argued that offshoring can lead to higher wages for unskilled U.S. workers.

"Things may be better than they would have been had there been no offshoring," Mr. Grossman said. When a company offshores some work, its remaining workers become more productive. It can thus expand, hire more workers -- perhaps even some of those whose work was offshored -- to do jobs that can't be offshored, and it can pay at least some of them more.

The proof is that wages of unskilled, blue-collar workers didn't do worse than they actually did between 1997 and 2004, given two strong, offsetting economic forces: the surge in productivity, or output per hour of work, which should have lifted their wages, and the decline in prices of imports, which should have pushed down their wages by lowering the prices of the competing goods these workers made.

Anthony Venables of the London School of Economics argued that when an industry in a rich country starts trading with a poor country, the wages in the rich country may actually pull further away from those in the poor country, instead of converging down to the lower level as standard economic theory predicts. The reason? The industry in the rich country may rely on many local inputs that its competitors in a new foreign market don't have -- access to specialized workers, for example, or daily face-to-face contact with competitors and customers.

This proximity can give the domestic industry a big advantage in the new foreign market, making it more productive and able to pay higher wages.

A third Jackson Hole presentation said the puzzle over why the U.S. borrows so much from China and other developing countries may have a relatively benign explanation -- perhaps alleviating concern over the enormous U.S. trade deficit.

In the textbooks, rich countries are supposed to lend to poor countries, because investment opportunities are better there. But the U.S. borrows hundreds of billions of dollars a year, especially from China, to finance the massive U.S. trade deficit.

Economists worry that these foreigners could suddenly lose their appetite for lending to the U.S., producing a sharp drop in the dollar and a rise in U.S. interest rates. But Eswar Prasad, Raghuram Rajan and Arvind Subramanian of the International Monetary Fund found that over time, developing countries that borrow from the rich actually grow more slowly, while developing countries that lend to

rich countries grow more quickly.

They conclude that incomes in developing countries such as China have grown faster than the Chinese ability to spend and invest, perhaps because their financial systems are underdeveloped. The excess, which takes the form of savings, gets sent abroad, into U.S. Treasury bonds or mortgages.

While this helps explain today's unusual imbalances, the authors warned that this doesn't mean they can be sustained for long.

Another imbalance that has preoccupied economists and central bankers around the world is the sharp rise in many countries in housing prices, which in turn reflects unusually low long-term interest rates world-wide, even in the U.S., where the Fed has steadily raised short-term rates during the past two years. The threat of a sharp reversal is one of the Fed's central preoccupations today, and one that dominated much of the informal chatter between sessions at the conference. For now, the Fed sees an orderly cooling but is on the lookout for a more convulsive decline.

Kenneth Rogoff at Harvard University observed that prices of assets such as houses, bonds and stocks have remained volatile as the business cycle has become more stable around the world. Mr. Rogoff argued that the success of world central banks in bringing down inflation and stabilizing growth has made the world less risky. Counterintuitive though it sounds, this makes markets seem more risky. Here's why: Investors demand less compensation for the risk of holding an asset, so they bid up its price and accept a lower return. But at their new, higher level, asset prices are much more sensitive to perceived changes in risk. Thus, Mr. Rogoff said, higher and more volatile asset prices might be the price of successful monetary policy, an observation former Fed Chairman Alan Greenspan made at last year's conference.

The lesson for the Fed and other central bankers, he says, isn't to target the prices of assets but to be careful of how their policies and communications can unsettle financial markets.

Jackson Hole may have left participants more optimistic about the benefits of globalization, but not necessarily for its current prospects. Federal Reserve Chairman Ben Bernanke opened the conference by saying that "further progress in global integration" is threatened by protectionist pressure from those who stand to lose the most.