

The Great Wall of China

Globalization: Opportunity or Threat?

The U.S. economy is increasingly influenced by the global economy. In 1950 the portion of the U.S. economy that was related to the global economy, as measured by the sum of exports plus imports as a percentage of GDP, was about 7%. By 1975 this percentage doubled to 14% and has continued to increase to nearly 25% today. This means that the flow of goods and services back and forth between the U.S. and foreign countries accounts for about 25% of our economic activity - a very significant percentage and one that is expected to continue to rise. Lately many news headlines focus on lost jobs due to outsourcing and offshoring. The concern is that expanding trade is letting good jobs drain from the United States to China, India and other countries where workers earn much lower salaries. The natural tendency is to place restraints on trade to protect jobs. Thus, is globalization, or the expansion of international trade, a good thing?

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: 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 excelling at their jobs 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 computers, 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 two-fold benefit - greater efficiency and lower costs for U.S. firms and consumers.

What are outsourcing and offshoring?

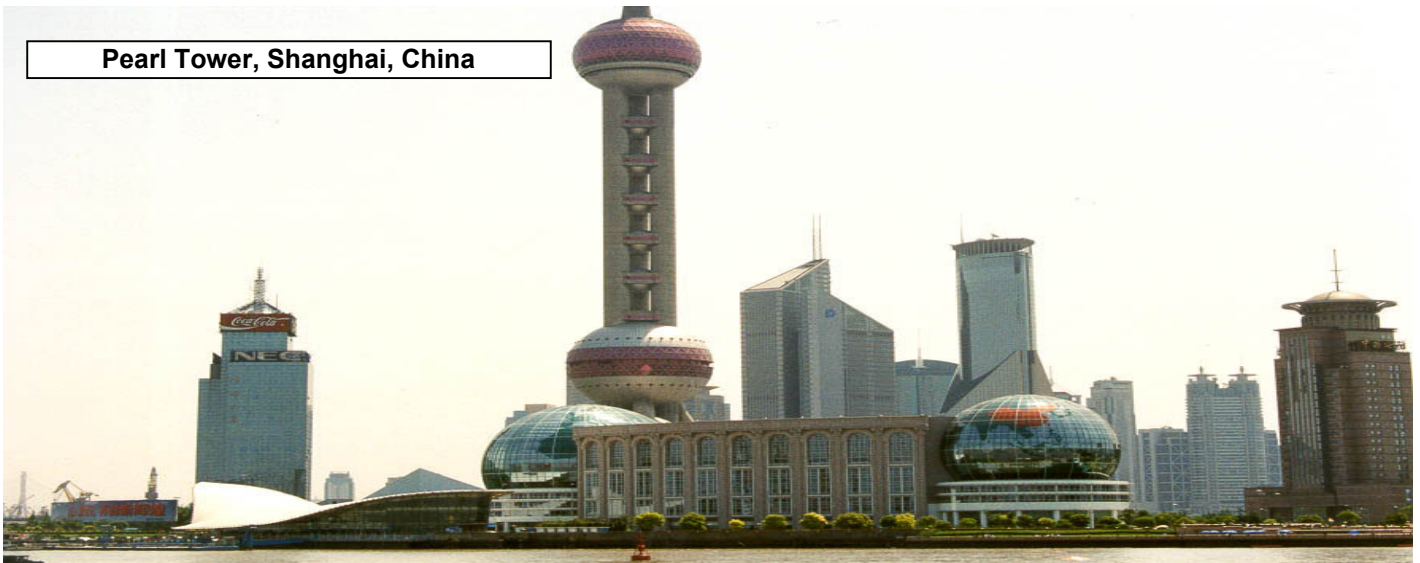
According to Robert Parry of the Federal Reserve Bank of San Francisco, "outsourcing is simply contracting out functions that had been done in-house, a longtime U.S. practice." For example, "When a car manufacturer in Michigan buys brake pads from an intermediate supplier in Ohio rather than produce 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. According to Parry, "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."

"Recession is when your neighbor loses his job. Depression is when you lose yours. And recovery is when Jimmy Carter loses his."

Ronald Reagan

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

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. Open trade also creates opportunities in the U.S. as 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 goods and services.

In addition, globalization can help increase productivity growth in the U.S. While clearly productivity creates pain for displaced workers, 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 (see our November 2003 Commentary titled "Productivity Miracle"). 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.

And for most displaced workers there is hope. Over time, they generally find new jobs, often in entirely new sectors of the economy. For example, by one estimate, about a quarter of today's labor force is in jobs that didn't even exist in 1967. The key is to create a flexible economy, one where workers and capital can move about freely to pursue new opportunities. The next 35 years will likely see the creation of many more jobs in unforeseen areas.

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

Robert Parry believes that "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."

Further, Parry suggests that "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. It's the hope and promise we must provide for future generations of Americans."

"There are no great limits to growth because there are no limits of human intelligence, imagination, and wonder."

Ronald Reagan, 1983