Globalization Myths

What Adam Smith can Learn from Joe Sixpack

BY EDWIN S. RUBENSTEIN

Most workers worry when an emerging nation like India or China, helped by low wages, technology imported from the U.S., and undervalued currencies, cause layoffs from good American jobs. This is a hot issue now, and will be in the decades to come.

Mainstream economists are among the few who still say: "No problem." In February 2004 Gregory Mankiw, a Harvard professor then serving as chairman of the President's Council of Economic Advisors, dismissed the transfer of U.S. manufacturing and service operations offshore as only "the latest manifestation of the gains from trade that economists have talked about at least from Adam Smith….More things are tradable now than in the past, and that's a good thing."[1]

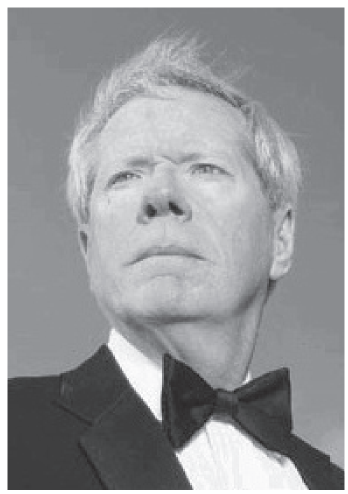
Mankiw and like minded economists—among them Alan Greenspan—admit that good jobs may be lost in the short run. But over time real GDP (both here and in China) will go up as prices fall and workers switch to jobs in which their productivity is higher.

Comparative vs. Absolute Advantage

This result is ordained by the economic law of "comparative advantage."

But the law of comparative advantage no longer applies. It reflects conditions of the late eighteenth century, when production depended on domestic supplies of capital and labor, as well as locally available technology. Under those conditions it made sense for nations to specialize in goods for which they were "comparatively" well suited, and import the others. Free trade was a win-win proposition. All nations benefited.

Today capital and labor move easily across international borders. Owners of capital maximize the return on their investment by shifting production to countries where capital is scarce relative to labor—e.g., China. Similarly, workers raise their living standards by migrating to countries where labor is scarce relative to capital—e.g., the U.S. Capitalists and low income workers reap benefits from this globalization; most American workers lose ground.



Syndicated columnist Paul Craig Roberts

The outsourcing of American operations abroad has nothing to do free trade based on comparative advantage. U.S. corporations are not sending capital abroad to increase their ability to compete at home. They are seeking what Paul Craig Roberts calls "absolute advantage"—the cheapest labor available. Trade based on absolute advantage implies a leveling of international wage differentials, pushing ours down and those of our trading partners up.

Two recent developments made possible the supremacy of absolute advantage over comparative advantage. One is the collapse of world socialism, which opened India's and China's vast, under-utilized labor supply to multinational corporations. Second is the high speed internet, which has expanded the range of activities that can be moved offshore.

The globalization of work tends to start from the bottom up. The first jobs to be moved abroad

---

***Edwin S. Rubenstein** is president of ESR Research, Inc., a research organization focusing on public policy and economic trends. He was formerly Director of Research at the Hudson Institute.*

are typically simply assembly tasks, followed by manufacturing. More recently, communications technology has expanded the range of "tradable" items to services. Service offshoring, which began with call centers and back-office operations, has moved up the value chain to computer programming, accounting, legal services, financial analysis, and health diagnostics. At the end of this progression is the work done by scientists and engineers in R&D laboratories.

Writing in *Foreign Affairs* (March/April 2006), Princeton economist and former Federal Reserve vice chairman Alan Blinder warns that education no longer protects U.S. workers from foreign competition: "The critical divide in the future may instead be between those types of work that are easily deliverable through a wire (or via wireless connections) with little or no diminution in quality and those that are not."

The crucial distinction, according to Blinder, is between personal and impersonal services. Personal services require a local presence and/or face to face contact—think of your waiter, your babysitter, your gardener, your cleaning lady, your nurse. These people can work at high end jobs (dentist, divorce lawyer), or low end jobs (garbage man, janitor). They are all outsource safe. Regardless of their education, their wages will be set by local market forces of supply and demand.

(Note that a disproportionate share of workers in many of these "safe" occupations are immigrants. That is no coincidence: mass immigration and outsourcing are both means of substituting cheap foreign-born labor for native-born workers.)

That brings us to workers providing "impersonal services." This category includes people in jobs that were once bedrocks of middle-class life: accountants, assembly line workers, clerks, computer programmers, secretaries. At one time they were deemed untradable; communications technology has changed all that.

Service occupations most easily outsourced abroad are ranked by Blinder (see table above).

To obtain a ballpark figure of the number of U.S. threatened by offshoring, consider the composition of the U.S. labor market at the beginning of 2007. There were 14.1 million manufacturing jobs—the vast majority producing items that can be produced abroad and shipped to the U.S. All these jobs are vulnerable. The service sector employed 115.1 million workers at the end of last year, and Blinder estimates that between 28 and 42 million of them are susceptible to offshoring in the electronic future.

Bottom line: 42 to 56 million U.S. jobs could be lost to offshoring.

For perspective, consider there are currently (March 2007) only 6.7 million unemployed persons in the U.S., and the immigrant workforce (legal and illegal) numbers 23 million.

JOBS MOST VULNERABLE TO OUTSOURCING
(Ranked by economist Alan Blinder)

Occupation	Number of U.S. Workers
Computer programmers	389,000
Data entry keyers	296,700
Actuaries	15,700
Film and video editors	15,200
Mathematicians	2,930
Medical transcriptionsists	90,380
Interpreters and translators	21,930
Economists	12,470
Graphic designers	178,530
Bookkeeping, accounting, and auditing clerks	1,815,340
Microbiologists	15,120
Financial analysts	189,910

Source: David Wessel and Bob Davis, "Pain From Free Trade Spurs Second Thoughts," *Wall Street Journal*, March 28, 2007. Page 1.

Let's assume a worst case scenario in which half of the 56 million jobs lost to outsourcing result in permanent unemployment. Based on today's employment situation, this would raise the national unemployment rate to 19 percent—a level not seen since the Great Depression.

Corporate America, which has dismissed thousands of their U.S. employees and replaced them with foreigners, claims that the dollars saved by foreign outsourcing are reinvested stateside, creating more jobs for workers in the U.S. This pro-globalization rhetoric is repeated ad nauseam by politicians, industry lobbyists, and think-tank economists.

Unfortunately, there is no hard evidence to support this happy talk.

During the past six years (January 2001 to January 2007) manufacturing lost 2.8 million jobs, almost 17 percent of the manufacturing labor force. Not a single manufacturing payroll classification added workers during this period. The rising trade deficit in manufactured goods—much of it due to imports from U.S.-owned facilities located abroad—is responsible for much of this decline.

From 2001 to 2006 the information sector of the U.S. economy lost 644,000 jobs, or 17.4 percent of its workforce. Computer systems design—an occupation loaded with newly graduated immigrant students—lost 105,000 jobs, or 8.5 percent of its workforce. Moreover, the government's own labor force projections for 2004 to 2014 foresee a slowing of computer related employment "…as the software industry begins to mature and as routine work is routinely outsourced overseas." [See Daniel E. Hecker, "Occupational employment projections to 2014," *Monthly Labor Review*, November 2005.]

The number of workers making semiconductors and electronic equipment shrank by 37 percent between 2001 and 2006. The workforce in motor vehicles and parts declined 12 percent. Furniture and related products lost 17 percent of its jobs. There were 20 percent fewer paper and paper products workers.

Engineering jobs are in decline because the manufacturing sectors that employ engineers are in decline. BLS payroll numbers show a total of 69,000 jobs created in all fields of architecture and engineering, including clerical personnel, over the 2001 to 2006 period. That comes to a mere 14,000 jobs per year. Yet U.S. employers routinely push for more visas for foreign engineering students.

In recent years U.S. job creation was limited to four areas: education and health services, state and local government, leisure and hospitality, and financial services. There was no job growth outside of these four non-tradable services.

Winners and Losers

Does globalization make the world richer? It probably does. But the real issue is the distribution of those gains.

The American economy used to look like a bell curve, with a big bulge in the middle. The bulge of middle-class jobs was the key to both our economic and political stability. Those jobs—from assembly line work to data entry to securities analysis to accounting and radiology—are either gone or are threatened by what columnist Thomas Friedman calls the "flattening" of the world.

We are in danger of moving from a bell curve economy to a bar-bell economy, with a large high end, a larger low end, and nothing in the middle. Mass immigration has swelled the left side of the bar bell. Outsourcing has enriched the owners of capital at the right side. Both trends have contributed to economic malaise at the middle of the income distribution.

Where will it end? If American workers sense they are at risk of being losers—even if those fears are overstated or ignore the benefits of cheap imports—the political consensus for encouraging further globalization will evaporate. Protectionism, capital controls, and an immigration moratorium could become politically attractive.

Hopefully we will enact policies that protect American workers before that happens. ■

End Note

[1] Quoted in Alan Blinder, "Offshoring: The Next Industrial Revolution?", *Foreign Affairs*, March/April 2006.