

Offshoring can benefit workers of all skill levels

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Recent commentary about the state of American workers has emphasised income inequality - declining prospects of low-skilled workers relative to their more highly skilled counterparts. Part of the discussion has centred on the role played by globalisation.

The focus of US concerns over globalisation is offshoring. Globalisation may have boosted the earnings of highly skilled workers while gutting the prospects of lower-skilled workers whose jobs are likely to be offshored. Perhaps, as Princeton economist Alan Blinder argued provocatively recently, offshoring will soon lower wages of higher-skilled service workers, too.

Or not. The offshoring debate of the past few years has obscured some basic insights from economics and about economic policy in a globalising world. In particular, offshoring can generate gains not only for the economy as a whole, but also for low-skilled workers. American policy should not succumb to anti-globalisation forces but focus on removing home-grown impediments to wage growth of low-skilled workers.

Traditional trade theory - and discussions of comparative advantage - centred on goods produced entirely in one location. But the present practice of trade centres as much on trade in tasks as trade in goods. An "American-made" car, for example, may have most of its value added generated beyond US shores. Offshoring can, then, be thought of as a kind of trade in tasks.

The concept of trade in tasks can be traced to Adam Smith's description of the division of labour in a pin factory in 18th-century Britain. Now think of the pins in a man's shirt. Victor Fung, chief executive of Li & Fung, the trade sourcing company, observed at a Columbia Business School lecture this year that a shirt imported to the US from Hong Kong includes tasks of workers from as many as 10 countries. Today, lower costs of transport and communications enhance the possibilities for trade in tasks in auto assembly, radiology, tax preparation and even study tips for economics. Most of the growth in American business service imports over the past decade represents task trade within US parent companies and their overseas subsidiaries.

America's labour market tells a related story. The US is specialising in tasks not easily carried out remotely and importing more routine tasks that can be performed more cheaply abroad.

Offshoring as task trade can generate "gains from trade". But there is more to the argument. It may boost productivity enough to raise the wages of low-skilled as well as high-skilled workers.

Why? Recent research by Princeton economists Gene Grossman and Esteban Rossi-Hansberg reminds us that popular discussion of offshoring addresses only the effect of new overseas workers on global labour supply and the wages of US workers. However, increases in prospects for offshoring generate two additional economic effects. The first, the result of greater labour market integration, is a decline in the price of labour-intensive goods and downward pressure on the wages of low-skilled US workers most affected by the new global labour market. The second effect is on productivity: international shifting of tasks reduces costs, particularly in sectors relying more on low-skilled workers. These sectors have then an incentive to expand, and low-skilled workers find new jobs with higher productivity and wages.

How do these effects play out in the data? Professor Grossman and Mr Rossi-Hansberg provide suggestive evidence. The relative price effects of greater foreign production have decreased wages of low-wage US workers. But the economists estimate that the productivity effect dominates the labour-supply effect. That is, not only has offshoring not harmed US wages; it has

actually offset some wage-reducing effects from the integration of large emerging economies such as China and India. These salutary effects would probably remain even as higher-skilled tasks become candidates for trade. For US workers of all skill levels, offshoring is akin to technological progress improving productivity and wages.

The benefits of offshoring as trade in tasks underscore economists' familiar refrain that political leaders should not bash globalisation, but those benefits also suggest affirmative roles for US economic policy. The most significant is to expand public support for training to enhance flexibility in the labour market; close behind is to reduce the corporate tax, borne in no small part by domestic workers.

Trade in tasks also generates a significant implication for trade agreements. The US has emphasised bi-lateral trade agreements in recent years. In a world of trade in goods completed within natural borders this departure from a global trade agreement would not be serious. But in the example of the man's shirt, a business leader such as Mr Fung must deal with multiple trading regimes in an environment of bilateral agreements.

Global opportunities created by large emerging economies will affect wages in the US, particularly for low-skilled workers. But to blame companies' entrepreneurial response to the rapidly changing world - offshoring or other management practices - is a mistake.

The writer, dean and professor of finance and economics at Columbia Business School, was chairman of the council of economic advisers under President George W. Bush 2001-03