September 9, 2004

An Elder Challenges Outsourcing's Orthodoxy

By STEVE LOHR
New York Times

At 89, Paul A. Samuelson, the Nobel Prize-winning economist and professor emeritus at the Massachusetts Institute of Technology, still seems to have plenty of intellectual edge and the ability to antagonize and amuse.

His dissent from the mainstream economic consensus about outsourcing and globalization will appear later this month in a distinguished journal, cloaked in clever phrases and theoretical equations, but clearly aimed at the orthodoxy within his profession: Alan Greenspan, chairman of the Federal Reserve; N. Gregory Mankiw, chairman of the White House Council of Economic Advisers; and Jagdish N. Bhagwati, a leading international economist and professor at Columbia University.

These heavyweights, among others, are perpetrators of what Mr. Samuelson terms "the popular polemical untruth."

Popular among economists, that is. That untruth, Mr. Samuelson asserts in an article for the Journal of Economic Perspectives, is the assumption that the laws of economics dictate that the American economy will benefit in the long run from all forms of international trade, including the outsourcing abroad of call-center and software programming jobs.

Sure, Mr. Samuelson writes, the mainstream economists acknowledge that some people will gain and others will suffer in the short term, but they quickly add that "the gains of the American winners are big enough to more than compensate for the losers."

That assumption, so widely shared by economists, is "only an innuendo," Mr. Samuelson writes. "For it is dead wrong about necessary surplus of winnings over losings."

Trade, in other words, may not always work to the advantage of the American economy, according to Mr. Samuelson.

In an interview last week, Mr. Samuelson said he wrote the article to "set the record straight" because "the mainstream defenses of globalization were much too simple a statement of the problem." Mr. Samuelson, who calls himself a "centrist Democrat," said his analysis did not come with a recipe of policy steps, and he emphasized that it was not meant as a justification for protectionist measures.

Up to now, he said, the gains to America have outweighed the losses from trade, but that outcome is not necessarily guaranteed in the future.

In his article, Mr. Samuelson begins by noting the unease many Americans feel about their jobs and wages these days, especially as the economies of China and India emerge on the strength of their low wages, increasingly skilled workers and rising technological prowess. "This is a hot issue now, and in the coming decade, it will not go away," he writes.

The essay is Mr. Samuelson's effort to contribute economic nuance to the policy debate over outsourcing and trade. The Journal of Economic Perspectives, a quarterly published by the American Economic Association, has a modest circulation of 21,000 but it is influential in the field.

Indeed, Mr. Bhagwati and two colleagues, Arvind Panagariya, an economics professor at Columbia, and T. N. Srinivasan, a professor of economics at Yale University, have already submitted an article to the journal that is partly a response to Mr. Samuelson. Theirs is titled "The Muddles Over Outsourcing."

The Samuelson critique carries added weight given the stature of the author. "He invented so many of the economic models that everyone uses," noted Timothy Taylor, managing editor of the Journal of Economic Perspectives.

For generations of undergraduates, starting in 1948, the study of economics has meant a Samuelson textbook, now in its 18th edition, with William Nordhaus, a Yale economist, as a co-author since the 12th edition. Because he has taught at M.I.T. for six decades, the elite ranks of the economics profession are filled with Mr. Samuelson's former students, including Mr. Bhagwati and Mr. Mankiw.

According to Mr. Samuelson, a low-wage nation that is rapidly improving its technology, like India or China, has the potential to change the terms of trade with America in fields like call-center services or computer programming in ways that reduce per-capita income in the United States. "The new labor-market-clearing real wage has been lowered by this version of dynamic fair free trade," Mr. Samuelson writes.

But doesn't purchasing cheaper call-center or programming services from abroad reduce input costs for various industries, delivering a net benefit to the economy? Not necessarily, Mr. Samuelson replied. To put things in simplified terms, he explained in the interview, "being able to purchase groceries 20 percent cheaper at Wal-Mart does not necessarily make up for the wage losses."

The global spread of lower-cost computing and Internet communications breaks down the old geographic boundaries between labor markets, he noted, and could accelerate the pressure on wages across large swaths of the service economy. "If you don't believe that changes the average wages in America, then you believe in the tooth fairy," Mr. Samuelson said.

His article, Mr. Samuelson added, is not a refutation of David Ricardo's 1817 theory of comparative advantage, the Magna Carta of international economics that says free trade allows economies to benefit from the efficiencies of global specialization. Mr. Samuelson said he was merely "interpreting fully and correctly Ricardoian comparative advantage theory." That interpretation, he insists, includes some "important qualifications" to the arguments of globalization's cheerleaders.

Those qualifications are not new to Mr. Samuelson. He noted that in a different context, he touched on similar matters as far back as 1972 in a lecture he delivered shortly after he won his Nobel Prize, titled "International Trade for a Rich Country."

For his part, Mr. Bhagwati does not dispute the model that Mr. Samuelson presents in his article. "Paul is a great economist and a terrific theorist," he said. "And in markets like information technology services, where America has a big advantage, it is true that if skills build up abroad, that narrows our competitive advantage and our exports will be hit."

But Mr. Bhagwati, the author of "In Defense of Globalization" (Oxford University Press, 2004), says he doubts whether the Samuelson model applies broadly to the economy. "Paul and I disagree only on the realistic aspects of this," he said.

The magnified concern, Mr. Bhagwati said, is that China will take away most of American manufacturing and India will take away the high-technology services business. Looking at the small number of jobs actually sent abroad, and based on his own knowledge of developing nations, he concludes that outsourcing worries are greatly exaggerated.

As an example, Mr. Bhagwati pointed to the often-repeated estimates that, because of the Internet, as many as 300 million well-educated workers, mostly from India and China, could now enter the global work force and compete with Americans for skilled jobs.

In their paper, Mr. Bhagwati and his co-authors write that such an assessment of the education systems of India and China "almost borders on the ludicrous." In an interview, Mr. Bhagwati said, "You have a lot of people, but that doesn't mean they are qualified. That sort of thinking is really generalizing based on the kind of Indian and Chinese people who manage to make it to Silicon Valley."

The Samuelson model, Mr. Bhagwati said, yields net economic losses only when foreign nations are closing the innovation gap with the United States.

"But we can change the terms of trade by moving up the technology ladder," he said. "The U.S. is a reasonably flexible, dynamic, innovative society. That's why I'm optimistic."

The policy implications, he added, include increased investment in science, research and education. And Mr. Samuelson and Mr. Bhagwati agree that the way to buffer the adjustment for the workers who lose in the global competition is with wage insurance programs.

"You need more temporary protection for the losers," Mr. Samuelson said. "My belief is that every good cause is worth some inefficiency."