# The Ledger

Federal Reserve Bank of Boston's Economic Education Newsletter

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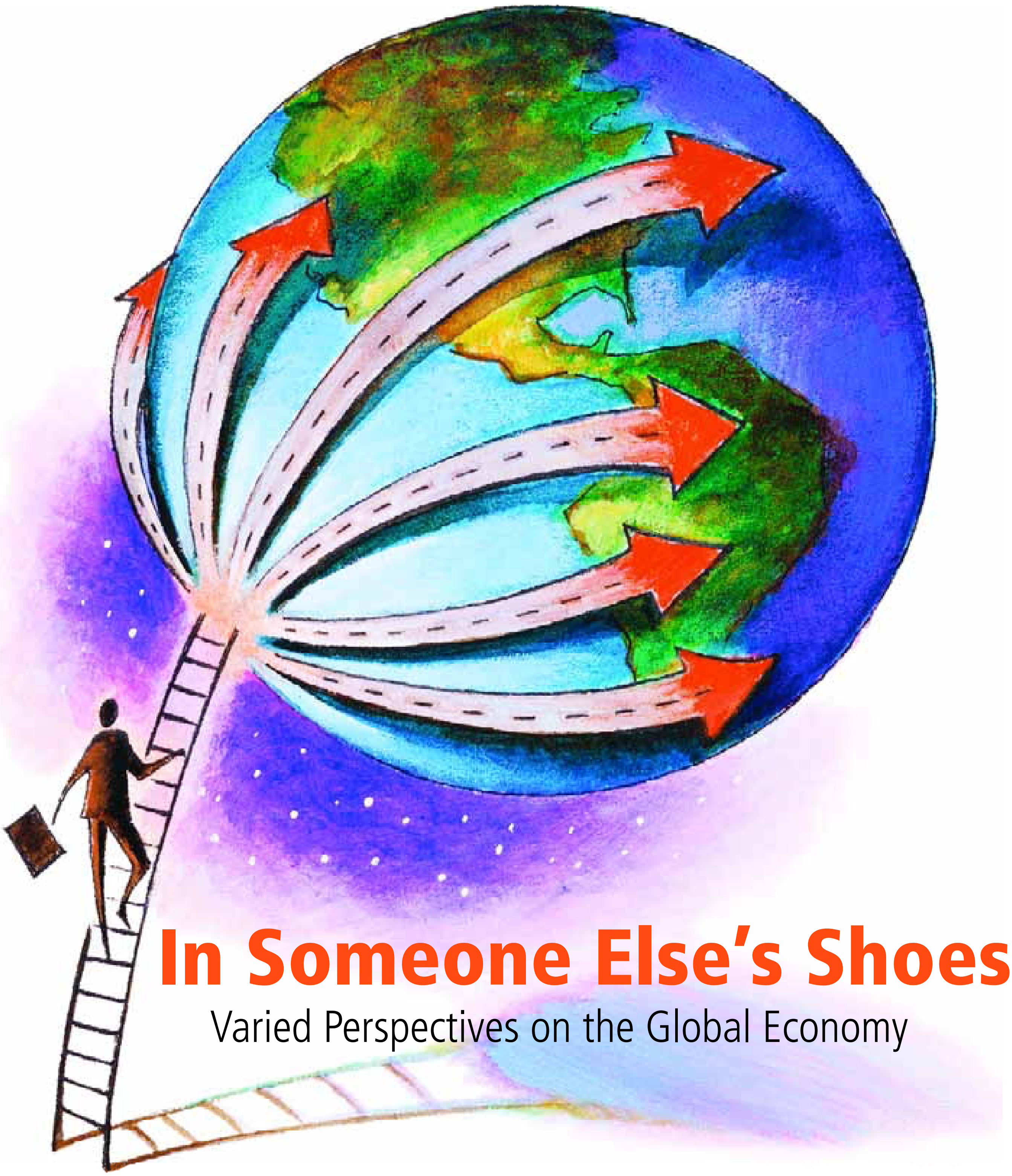

## In Someone Else's Shoes

Varied Perspectives on the Global Economy

# The Ledger

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# In this issue



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# Introduction
# GLOBALIZATION:
## More Questions Than Answers

**Boston, Massachusetts**
**Thanksgiving Day — 1956**

Another successful Thanksgiving: lots of good food and no ruffled feathers.

The uncles are taking half-hearted stabs at the last wedge of Boston cream pie (which, as everyone knows, isn't really a pie). And since it's 1956, no one is after them to clear the table or wash the dishes. They're free to sit around and talk about the same three things they talk about every Thanksgiving: beer, tires, and shoes.

Their conclusions? The same as last year and the year before: (1) Narragansett is a better beer than Knickerbocker, and Pickwick Ale beats Ballantine; (2) Goodyear versus Firestone is a toss-up; (3) Florsheim shoes shouldn't be mentioned in the same breath as Wright Arch Preservers.

And it's that last one — the discussion about shoes — that's pure New England.

All across mid-twentieth century America, uncles might have sat at Thanksgiving tables and discussed the relative merits of beers or tires or football teams. But only in New England did they know enough, or care enough, to talk shoes. . . .

If you lived in New England between 1860 and 1960, there was a good chance you knew people — family members, friends, neighbors — who earned their living from shoe manufacturing or textile production. Shoes and textiles put food on the table, covered the rent, kept the kids in clothes, and provided a good chunk of the tax base for municipal services.

There were also intangibles. New Englanders took a certain pride in supplying footwear and cloth to the world. It was what they did and, to a certain extent, it defined the region they called home.

Yet even as early as the 1920s, New England's shoe factories and textile mills were heading south — literally and figuratively. Lower production costs lured them first to the American South, and then ultimately to foreign countries where production costs were even lower. New England seemed destined to become an economic backwater with little growth and few prospects for the future.

But neither bad times nor good times last forever. After a long stretch of lean years the region's economy bounced back, thanks largely to a mix of high-tech, higher education, financial services, and health care. By the end of the 20th century, New England was faring better than anyone would have dared to predict after the shoe factories and textile mills closed their doors.

But there's no happily-ever-after in economic life. Things are always changing.

The transition to a more interdependent global economy has created a new set of challenges, and this time around the potential effects aren't limited to a particular region or industry. Go anywhere in the United States, talk to people in any sector of the economy — manufacturing, financial services, customer support, information technology, blue collar, white collar — and it seems as if everyone is trying to figure out what comes next. Some are optimistic, others are apprehensive, and many still aren't sure what to make of it all.

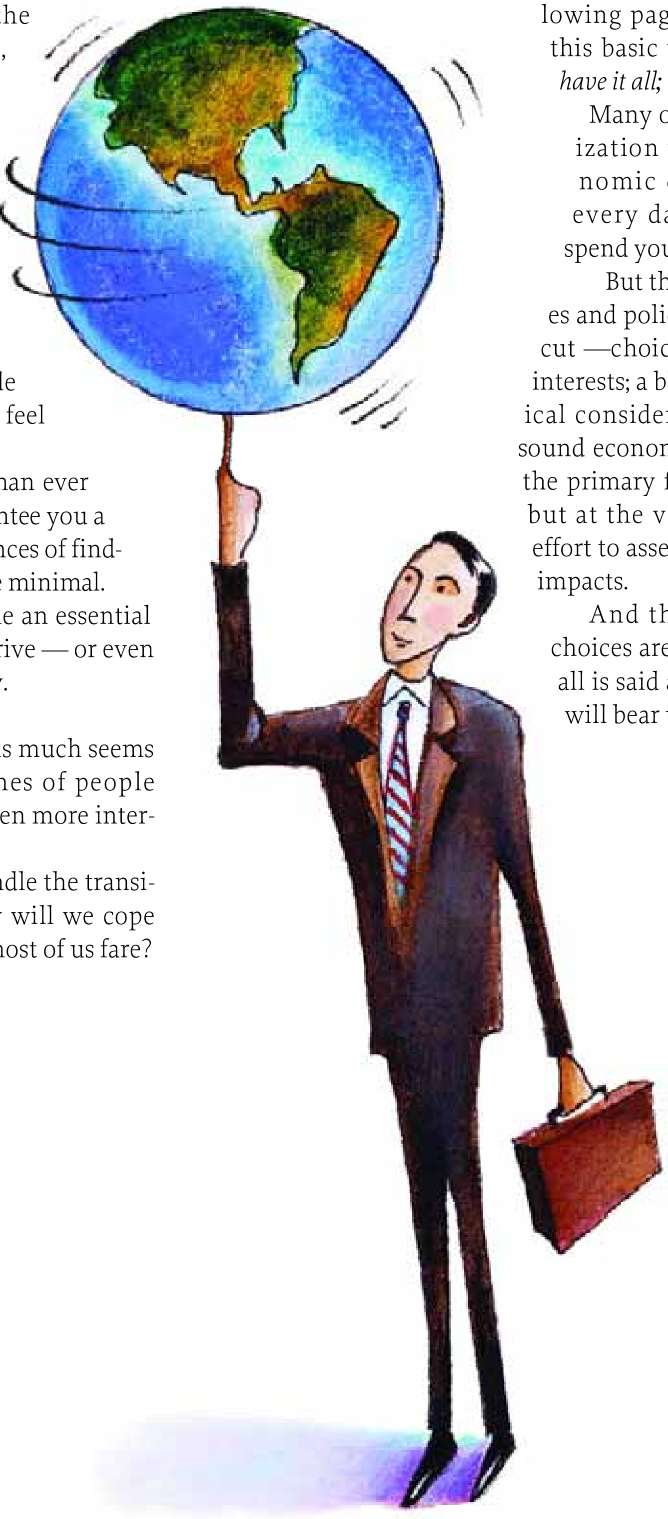
Maybe it's too soon to know exactly how globalization will affect our lives and long-term prospects, but there are some early indications:

- If you're a consumer, things have never been better. You have access to an astounding selection of products and services from around the world, at prices that are more affordable than ever.
- If you're a worker in one of the wealthier developed countries, you may be working longer hours with fewer employer-paid benefits and less job security . . . . Maybe you're wondering if there's any real upside to globalization.
- If you're a worker in a developing country, you may be working long hours, with few employer-paid benefits, and little job security, yet you still might feel as if life is getting better for you.
- Education is more important than ever before. It won't necessarily guarantee you a good job, but without it your chances of finding one in the global economy are minimal.
- Adapting to change has become an essential trait for anyone who hopes to thrive — or even survive — in the global economy.

And beyond that?

Predictions are risky, but this much seems almost inevitable: The fortunes of people around the globe will become even more intertwined than they are now.

Less certain is how we'll handle the transition to a global economy. How will we cope with the challenges? How will most of us fare?



The early expert consensus seems to be that globalization will lead to greater prosperity. But how widespread will it be? Will most of the gains go to a few big winners, or will there be increased opportunities for more of us to live well and prosper?

And what about those whose lives are disrupted in the transition — friends, neighbors, family members, fellow citizens? Should we do anything — *can* we do anything effective — to help them find a new place in the economy?

As always, don't expect us to come up with answers for you, and don't expect us to tell you that globalization will be good or bad for you. You'll have to figure that out for yourselves. But as you make your way through the following pages we hope you'll remember this basic tenet of economics: *We can't have it all; we have to make choices.*

Many of the choices related to globalization will be straightforward economic decisions. You make them every day when you decide how to spend your money.

But there will also be political choices and policy decisions that are less clear-cut —choices that require a balancing of interests; a blending of economic and political considerations. For better or worse, sound economic reasoning won't always be the primary factor guiding these decisions, but at the very least we can make every effort to assess the true costs and economic impacts.

And this is worth repeating: The choices are yours to make, because when all is said and done, you're the ones who will bear the costs. ■

# G9: A Globalization Glossary

## Nine Terms Often Heard in Discussions of the Global Economy

Certain terms find their way into most news stories and discussions about globalization. (OK, maybe you won't hear "absolute advantage" and "comparative advantage" quite so often as the others, but they are important concepts nevertheless.)

### World Trade Organization (WTO)

Quick! For $50 and the match, what is the WTO?

You never know. This question just might come up during trivia night at the local social club. So, here's the answer, straight from the WTO web site. **http://www.wto.org/**

> The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business.

### The G8 Nations (Or is it G7? Or maybe G9?)

The G8 started out as the G6. Britain, France, Germany, Italy, Japan, and the United States first met in 1975 to discuss pressing economic and political issues. Canada joined them in 1976 (G7), and Russia became a full participant in 1998 (G8). Quoting from the G8 Information Centre **http://www.g7.utoronto.ca/**

> The G7/8 Summit has consistently dealt with macroeconomic management, international trade, and relations with developing countries. Questions of East-West economic relations, energy, and terrorism have also been of recurrent concern. From this initial foundation the summit agenda has broadened considerably to include microeconomic issues such as employment and the information highway, transnational issues such as the environment, crime and drugs, and a host of political-security issues ranging from human rights through regional security to arms control.

### Tariff

In the context of international trade, a tariff is a tax placed on imported goods. Tariffs are usually intended to protect domestic industries from foreign competition by making the foreign product more expensive, hence the term "protectionism."

Example: During the first half of the 19th century, American textile manufacturers had a problem. They couldn't compete with British manufacturers who were better established and better able to produce cloth at a lower price. What to do?

The American manufacturers convinced Congress to protect them with a tariff (tax) on imported textiles. The tariff narrowed the price gap between British cloth and American cloth by making British cloth much more expensive than it actually should have been. Of course, this didn't sit well with consumers in the American South or on the western frontier because they had to pay a higher price for cloth.

### Free Trade

"Free trade is the untaxed flow of goods and services between countries."

Clear and concise, this single sentence from the Wikipedia web site **http://en.wikipedia.org/wiki/Free_trade** defines free trade in its purest form — the ideal rather than the reality. But it's an ideal that seems more attainable now than at any time in recent memory. Although restrictions and tariffs haven't disappeared completely, many nations are moving in the direction of *freer* trade, making agreements that eliminate or drastically reduce trade barriers. (See NAFTA)

### Fair Trade

Fair trade and free trade are not one and the same. On a general level, "fair trade" describes the ongoing effort to ensure that any two trading partners — no matter if they're big, small, or somewhere in the middle — are on an equal footing. Example: If a country's aircraft industry receives a large government subsidy, it might have an unfair advantage over the unsubsidized aircraft industry in another country.

In a more specific sense, fair trade refers to an organized effort aimed at helping producers in developing countries gain access to world markets and receive an equitable price for their products. Some of the most common fair trade items are coffee, tea, cocoa, and fresh fruit.
**http://www.fairtrade.org.uk/index.htm**
**http://www.guardian.co.uk/fairtrade/0,12458,794377,00.html**

## Absolute Advantage and Comparative Advantage

Absolute and comparative advantage are essential to understanding the workings and benefits of trade. English economist David Ricardo developed a famous example during the early 1800s, using the production of wine and cloth in England and Portugal to illustrate his point. Follow this link if you want to read his example in the original **http://faculty.washington.edu/krumme/gloss/r.html#comparative**

If you'd prefer a shorter, contemporary example, here's one from our colleagues at the Federal Reserve Bank of Dallas. **http://www.dallasfed.org/fed/annual/2002/index.html**

> Societies reaped the benefits of specialization and trade for thousands of years before English economist David Ricardo (1772–1823) finally demonstrated why it works. His theory of comparative advantage helps explain why the United States exports soybeans to China and imports shoes in return.
>
> Suppose an average American worker can produce 100 bushels of soybeans or five pairs of shoes and a typical Chinese worker can turn out eight bushels of soybeans or four pairs of shoes.
>
> The United States is more productive than China in both industries, but consumers in both countries can still gain from specialization and trade. Shifting a U.S. worker from shoe factory to soybean farm produces a gain of 100 bushels of soybeans at the cost of five pairs of shoes. Shifting two Chinese workers from farm to factory raises shoe output by eight pairs but cuts soybean production by 16 bushels. The net effect is an increase of 84 bushels of soybeans and three pairs of shoes. Total output of both products reaches a maximum when the United States specializes in soybeans and China in shoes. Through trade, the two countries can divide the added production between themselves, leaving both better off than they were on their own.

## Current Account, Balance of Payments, and Balance of Trade

We could spend a lot of time and use a lot of words trying to develop a definition, but it wouldn't be nearly as good — or as easy to understand — as the one we found on the AmosWeb Gloss*arama **http://www.amosweb.com/gls/**

> Current Account: One of two parts of a nation's balance of payments (the other is capital account). It is a record of all trade, exports and imports, between a nation and the rest of the world. The current account is separated into merchandise, services, and what's called unilateral transfers. The merchandise part is nothing other than the well-known balance of trade. There's also a lesser known balance of services — the difference between services imported and exported.

## Outsourcing and Offshoring

This definition comes from another excellent online glossary, *Economics A-Z* on Economist.com **http://www.economist.com/research/Economics/** (As a bonus feature, you get to see all those cool British spellings like "specialising" and "labour.")

> [Outsourcing is] Shifting activities that used to be done inside a firm to an outside company, which can do them more cost-effectively. Big firms have outsourced a growing amount of their business since the early 1990s, including increasingly offshoring work to cheaper employees at firms in countries such as India. This has become politically controversial in countries that lose jobs as a result of offshoring. However, a firm that outsources can improve its efficiency by focusing on those activities in which it can create the most value; the firm to which it outsources can also increase efficiency by specialising in that activity. That, at least, is the theory. In practice, managing the outsourcing process can be tricky, particularly for more complex activities.

## NAFTA

This definition comes from the National Council on Economic Education web site, and it's part of a lesson plan *NAFTA: Are Jobs Being Sucked Out of the United States?* Here's the link:
**http://www.econedlink.org/lessons/index.cfm?lesson=EM50**

> NAFTA, the North American Free Trade Agreement, went into effect on January 1, 1994. The Agreement phases out most tariffs between the United States, Canada, and Mexico. Tariffs, which are taxes on imports, increase the price of foreign goods and thereby benefit domestic producers. The participants in NAFTA agreed to reduce tariffs by 50 percent immediately and to reduce them to zero over the following 15 years. Industries suffering the most because of the increased competition from foreign goods would be given extra time to adjust to the elimination of tariffs on their foreign competitors' products. ■

# walking a mile in someone else's shoes

## a selection of excerpts

Rare, indeed, is the person who takes a position that goes against his or her self-interest. And so it is with issues related to globalization.

An opinion piece in the local paper concluded that, "Sure, rapid economic change hurts individuals, and it's appropriate to help these displaced persons learn new skills and find new employment. Yet the lesson from Massachusetts's own history should be clear. Don't fear change. Open economies and free trade really do work." The writer's bio tells us he's "a partner in a private equity fund."

But what if he were a 50-year-old standing in the unemployment line six months after his company had moved offshore? He'd probably be a bit more apprehensive about the future and not particularly receptive to the notion that "open economies and free trade really do work."

Or step into the shoes of someone who heads an American manufacturing company that's been the economic anchor of its home city since the early 1900s. Your ties to the community have always been strong, but now you face an unpleasant choice: move overseas or go out of business. All your competitors have shifted production offshore, and they're killing you on price. You've tried to cut costs, but your shareholders are demanding a higher return on their investment, and your customers are pressing you for lower prices. Ignore either group and you'll end up with plenty of time to work on your golf game or take up fly fishing.

And if you can't relate to the concerns of an unemployed assembly line worker or a hard-pressed factory manager, try stepping into the shoes of a consumer. Are you so committed to buying American-made products that you're willing to pay significantly more for a pair of sneakers or any number of other products? Our daily shopping behavior suggests the answer is "no."

Intellectually, we may be able to put ourselves in someone else's shoes. But when it's time to reach for our wallets, we're more likely to act out of self-interest.

Not that that's a bad thing. It's just human nature.

And since we're not out to change human nature, we've set a modest goal for this issue of *The Ledger*. Rather than serving up the usual assortment of original pieces, we're directing you to articles and web sites that offer diverse perspectives on globalization. We've included excerpts from each article or web site, along with details on how to find it.

One more thing: We're not pushing the views expressed in the articles or web sites. Our hope is simply that these resources will serve as a starting point for discussing the issues and challenges that surround the transition to a global economy.

We've tried to come up with articles and web sites that represent a range of views, but perhaps you know of others that (gasp!) may be even better than those we've found. If so, let us know so that we can share them with other readers.

Note: *New York Times* links take you to an abstract of the article. If you want to view the entire piece there's a charge of $3.95 per article. If you don't have money to spare, you can check to see if your local library has a *Times* archive. Or, if you enter the article's title in a search engine, you can often find it on another web site. Why didn't we just provide you with those links? Simple answer: The articles are not ours to give; they belong to the *Times*.

**The World Is Flat: A Brief History of the Twenty-First Century**
Thomas Friedman, Farrar, Straus and Giroux

**"It's a Flat World, After All"**
by Thomas Friedman, *New York Times Magazine*, April 3, 2005 http://select.nytimes.com/gst/abstract.html?res=F00C16F93E5B0C708CDDAD0894DD404482

*Thomas Friedman, a high-profile columnist for The New York Times, is mostly upbeat about globalization, but he cautions that we will have to make adjustments. The following excerpts are from "It's a Flat World, After All."*

Only 30 years ago, if you had a choice of being born a B student in Boston or a genius in Bangalore or Beijing, you probably would have chosen Boston, because a genius in Beijing or Bangalore could not really take advantage of his or her talent. They could not plug and play globally. Not anymore. Not when the world is flat, and anyone with smarts, access to Google and a cheap wireless laptop can join the innovation fray. . . .

When my software applications could connect seamlessly with all your applications, it meant that all kinds of work — from accounting to software-writing — could be digitized, disaggregated and shifted to any place in the world where it could be done better and cheaper.

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Globalization 1.0 (1492 to 1800) shrank the world from a size large to a size medium, and the dynamic force in that era was countries globalizing for resources and imperial conquest. Globalization 2.0 (1800 to 1900) shrank the world from a size medium to a size small, and it was spearheaded by companies globalizing for markets and labor. Globalization 3.0 (which started around 2000) is shrinking the world from a size small to a size tiny and flattening the playing field at the same time. And while the dynamic force in Globalization 1.0 was countries globalizing and the dynamic force in Globalization 2.0 was companies globalizing, the dynamic force in Globalization 3.0 — the thing that gives it its unique character — is individuals and small groups globalizing. Individuals must, and can, now ask: where do I fit into the global competition and opportunities of the day, and how can I, on my own, collaborate with others globally? But Globalization 3.0 not only differs from the previous eras in how it is shrinking and flattening the world and in how it is empowering individuals. It is also different in that Globalization 1.0 and 2.0 were driven primarily by European and American companies and countries. But going forward, this will be less and less true. Globalization 3.0 is not only going to be driven more by individuals but also by a much more diverse — non-Western, non-white — group of individuals. In Globalization 3.0, you are going to see every color of the human rainbow take part.

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This quiet crisis is the product of three gaps now plaguing American society. The first is an "ambition gap." Compared with the young, energetic Indians and Chinese, too many Americans have gotten too lazy. As David Rothkopf, a former official in the Clinton Commerce Department, puts it, "The real entitlement we need to get rid of is our sense of entitlement." Second, we have a serious numbers gap building. We are not producing enough scientists and engineers. We used to make up for that by importing them from India and China, but in a flat world, where people can stay home and compete with us, and in a post-9/11 world, where we are insanely keeping out many of the first-round intellectual draft choices in the world for exaggerated security reasons, we can no longer cover the gap. That's a key reason companies are looking abroad. The numbers are not here. And finally we are developing an education gap. Here is the dirty little secret that no CEO wants to tell you: they are not just outsourcing to save on salary. They are doing it because they can often get better-skilled and more productive people than their American workers.

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So parents, throw away the Game Boy, turn off the television and get your kids to work. There is no sugar-coating this: in a flat world, every individual is going to have to run a little faster if he or she wants to advance his or her standard of living. When I was growing up, my parents used to say to me, "Tom, finish your dinner — people in China are starving." But after sailing to the edges of the flat world for a year, I am now telling my own daughters, "Girls, finish your homework — people in China and India are starving for your jobs."

**“The Fruits of Free Trade”**
by W. Michael Cox and Richard Alm, Federal Reserve Bank of Dallas, Annual Report 2002
http://www.dallasfed.org/fed/annual/2002/index.html

*Michael Cox and Richard Alm make the case for free trade. They focus, not on the initial dislocations that free trade can bring, but on its long-range benefits.*

## THE HIGH COST OF PROTECTIONISM

How much does it cost to protect a job? An average of $231,289, figured across just 20 of the many protected industries. Costs range from $132,870 per job saved in the costume jewelry business to $1,376,435 in the benzenoid chemical industry. Protectionism costs U.S. consumers nearly $100 billion annually. It increases not just the cost of the protected items but downstream products as well. Protecting sugar raises candy and soft drink prices; protecting lumber raises home-building costs; protecting steel makes car prices higher; and so forth. Then there are the job losses in downstream industries. Workers in steel-using industries outnumber those in steel-producing industries by 57 to 1. And the protection doesn’t even work. Subsidies to steel-producing industries since 1975 have exceeded $23 billion; yet industry employment has declined by nearly two-thirds.

| Protected industry | **Jobs saved** | **Total cost (in millions)** | **Annual cost per job saved** |
|---|---|---|---|
| Benzenoid chemicals | 216 | $ 297 | $ 1,376,435 |
| Luggage | 226 | 290 | 1,285,078 |
| Softwood lumber | 605 | 632 | 1,044,271 |
| Sugar | 2,261 | 1,868 | 826,104 |
| Polyethylene resins | 298 | 242 | 812,928 |
| Dairy products | 2,378 | 1,630 | 685,323 |
| Frozen concentrated orange juice | 609 | 387 | 635,103 |
| Ball bearings | 146 | 88 | 603,368 |
| Maritime services | 4,411 | 2,522 | 571,668 |
| Ceramic tiles | 347 | 191 | 551,367 |
| Machine tools | 1,556 | 746 | 479,452 |
| Ceramic articles | 418 | 140 | 335,876 |
| Women’s handbags | 773 | 204 | 263,535 |
| Canned tuna | 390 | 100 | 257,640 |
| Glassware | 1,477 | 366 | 247,889 |
| Apparel and textiles | 168,786 | 33,629 | 199,241 |
| Peanuts | 397 | 74 | 187,223 |
| Rubber footwear | 1,701 | 286 | 168,312 |
| Women’s nonathletic footwear | 3,702 | 518 | 139,800 |
| Costume jewelry | 1,067 | 142 | 132,870 |
| **Total** | **191,764** | **$44,352** | |
| **Average (weighted)** | | | **$ 231,289** |

Source: G. C. Hufbauer and K. A. Elliott, ***Measuring the Costs of Protection in the United States,*** (Washington, D.C.: Institute for International Economics, 1994), pp. 11–13.
Appeared in ***Annual Report 2002***, Federal Reserve Bank of Dallas.

Attacks on free trade don’t make economic sense. In fact, the critics often get it backwards.

We hear that trade makes us poorer. It’s just not so. Trade is the great generator of economic well-being. It enriches nations because it allows companies and workers to specialize in doing what they do best. Competition forces them to become more productive. In the end, consumers reap the bounty of cheaper and better goods and services.

We hear that trade costs jobs and depresses wages. Again, it’s just not so. By spurring economic activity and reducing costs, trade helps create jobs. By enhancing productivity, it keeps U.S. companies vibrant, leading to fatter paychecks and added benefits. Workers protected by trade barriers might keep their jobs a while longer, but the costs in inefficiency and higher prices make it economic folly. Whenever we erect barriers to trade, we negate the gains from free exchange and competition. Trade protection degenerates into a negative-sum game in which special interests jostle for advantage at the expense of the common good.

We hear that exports are good because they support U.S. industry, but imports are bad because they steal business from domestic producers. Actually, imports are the real fruits of trade because the end goal of economic activity is consumption. Exports represent resources we don’t consume at home. They are how we pay for what we buy abroad, and we’re better off when we pay as little as possible. Mercantilism, with its mania for exporting, lost favor for good reason.

We hear that free trade isn’t fair trade. Cheap imports can hurt higher-cost U.S. suppliers, but consumers certainly will gain. Why penalize them with tit-for-tat retaliation that only raises prices in the United States? Other countries’ trade transgressions don’t warrant missteps of our own. A nation will consume more whenever it opens its markets, even if other nations don’t reciprocate.

We hear that trade makes us dependent on foreign suppliers, but America doesn't have the climate and resources to make everything it needs. Other nations can produce many goods and services at lower cost. The price of independence is too steep.

Americans can't afford to buy into these trade fallacies. As a society, we often have to choose between protecting domestic industries and opening markets. In a weakened economy, steelmakers, catfish farmers and other producers are lining up to declare war on imports, creating a potential hit on Americans' wallets. At the same time, U.S. negotiators are seeking to expand the world trading system with new free trade agreements.

We need to understand what's at stake. Being wrongheaded on trade increases the risk of making bad choices that will sap our economy and sour our relations with other nations. Getting it right will promote prosperity and peace.

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Although specialization and trade make us wealthier, most societies spend a lot of time, money and energy trying to thwart the exchange of goods and services. At home, companies pursuing their self-interest often breed monopolies that restrict supply and hike prices. The same impulse to stifle competition leads to a variety of trade measures aimed at imports.

As the United States reduced tariffs over the past six decades, producers turned to import quotas, antidumping penalties, domestic-content laws, "voluntary" export restraints and other nontariff barriers. Export subsidies, exchange-rate controls, trade licenses, and onerous labeling, packaging and technical requirements further tilt the market against foreign goods.

In whatever guise, protectionism is pure poison for an economy. Time and again, economic studies show that import restraints aren't worth it. They saddle consumers with huge costs. Dozens of researchers have reached this conclusion for a host of products, from steel, automobiles and semiconductors to textiles, apparel and farm products.

Even when they temporarily stave off job losses, trade barriers are costly. For example, trade protection saved 216 U.S. jobs in the production of benzenoid chemicals, used in suntan lotion and other products—but at a cost of nearly $1.4 million per worker. Because the chemical workers earn a fraction of the protectionist toll, it would cost far less to simply pay them not to work!

In case after case, the costs of protection outweigh the benefits. The tab for each job preserved in the luggage industry is nearly $1.3 million; in softwood lumber, more than $1 million; in sugar, more than $826,000. Moreover, some of the jobs saved are dirty, dangerous and low paying.

### "In Roaring China, Sweaters Are West of Socks City"

by David Barboza, *New York Times*, December 24, 2004
http://select.nytimes.com/gst/abstract.html?res=F40A1EFC35540C778EDDAB0994DC404482

*David Barboza describes how China emerged as one of the world's leading textile producers.*

DATANG, China – You probably have never heard of this factory town in coastal China, and there is no reason why you should have. But it fills your sock drawer.

Datang produces an astounding nine billion pairs of socks each year – more than one set for every person on the planet. People here fondly call it Socks City, and its annual socks festival attracts 100,000 buyers from around the world.

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Beyond the entrepreneurial vigor so palpable here, the textile business is a prime example of how the Chinese government's attempt to guide development more indirectly through local planning instead of outright state ownership is starting to pay off in a big way.

◆

In the late 1970's, Datang was little more than a rice farming village with 1,000 people, who gathered in small groups and stitched socks together at home, and then sold them in baskets along the highway.

Back then, government officials branded Datang's sock makers as capitalists and ordered them to stop selling socks. Now, they produce over a third of the world's output, and the government has nothing but praise for such entrepreneurs and their domination of the sock business.

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Signs of Datang's rise as a socks capital are everywhere. The center of town is filled with a huge government-financed marketplace for socks. The rice paddies have given way to rows of paved streets lined with cookie-cutter factories. Banners promoting socks are draped across buildings. And each year, Datang is decorated with balloons and flags for the annual socks fair.

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Many of the old government-owned operations are gone. Private enterprises are importing high-end machinery and luring millions of peasants from the countryside.

Since the early 1980s, when China began moving to a market economy, much of its competitive advantage was built on low-cost labor. Companies spend about 92 cents an hour for each worker in China, versus $1.20 in Thailand, $1.70 in Mexico and about $21.80 in the United States, according to a study by Goldman Sachs. Among big exporters, only India, at about 70 cents an hour, is cheaper.

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The Chinese government has also played a crucial role, opening huge swaths of land for development, forming giant industrial parks, doling out tax benefits and developing the infrastructure and transportation networks needed to move products quickly to market.

### "In Chinese Factory, Rhythms of Trade Replace Rural Life"

by Leslie T. Chang, *Wall Street Journal*, December 31, 2004

*If you're a student of American history, Leslie Chang's description of Yue Yuen will take you back to the early days of the American Industrial Revolution and the beginnings of the New England textile industry. To make a further comparison, check out the following links:*

*Lowell National Historical Park:*
***http://www.nps.gov/lowe/2002/home.htm***

*Tsongas Industrial History Center:*
***http://www.uml.edu/tsongas/index2.htm***

*New England Economic Adventure:*
***http://www.economicadventure.org/gazette/index.cfm***

DONGGUAN, China – On Saturday afternoons, the factory complex owned by the world's biggest shoe manufacturer shuts down. More than 70,000 workers, mostly young women from farming villages across China, pour out of the plants and into the dormitories and cafeterias, the paved streets and parks of the Yue Yuen industrial complex.

Yue Yuen is an entire universe that replaces the village world young migrants leave behind. Just like the farms from which these workers come, Yue Yuen has seasons and rhythms, but ones set by commercial dictates in countries thousands of miles away. Yue Yuen runs its own water-treatment systems and power stations. Within each factory compound are dormitories and canteens, a post-office and phone-company branches, medical clinics and shops. One factory complex has a 100-bed hospital, a kindergarten, a 300-seat movie theater and a performance troupe. The city sometimes borrows the ladder from its fire truck, the tallest one in the area, to put out fires.

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In a community such as Yue Yuen [migrants from the countryside] find new lives full of hard work and long hours, but conditions are far better than the sweatshops many imagine Chinese factories to be.

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One-third of the world's shoes are made in Guangdong, the province that borders Hong Kong. In this world, Yue Yuen is king. Established in 1989 by Pou Chen Corp. of Taiwan, Yue Yuen is the largest supplier to Nike, Adidas, Reebok and other brands.

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Yue Yuen runs some factories that make the raw materials for shoes and other factories that cut, stitch and assemble these various parts. It employs designers to work with shoe companies to develop new styles. A Yue Yuen assembly line now takes 10 hours to make a shoe, from readying raw materials to having a finished product ready to ship, compared with 25 days four years ago [in1999/2000].

China's new industrial might is powered by one of the largest migrations in human history. China now has 114 million migrants, people who left their rural villages to work in cities.

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At Yue Yuen, the salary is average — about $72 a month after deductions for room and board — and the company has a reputation for hard workdays and harsh managers. But wages are paid on time. Work is capped at 11 hours a day and 60 hours a week with Sundays off. Workers sleep 10 to a room with hot showers and adequate meals. Eighty-five percent of the workers at Yue Yuen are young women.

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In its first decade, Yue Yuen often worked employees through midnight with few days off. But in the late 1990s, customers such as Nike Inc. and Adidas Salomon AG pushed suppliers to improve worker conditions. Yue Yuen switched to an 11-hour workday and gave employees Sundays off. It established a counseling center for questions and complaints. It improved safety measures and abolished military-style calisthenics and uniforms.

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The Western companies that pushed factories to improve conditions also demanded lower prices. In 2001, Adidas initiated a program at Yue Yuen to increase efficiency. Workers say they work fewer hours but are more exhausted because tasks are precisely parceled out to ensure almost no downtime. Brands now give factories 30 days to deliver an order; three years ago it was 60 days; a decade back it was 90.

### "A New Pattern Is Cut for Global Textile Trade"

by Peter S. Goodman and Paul Blustein, *Washington Post*, November 17, 2004 http://www.washingtonpost.com/wp-dyn/articles/A55462 2004Nov16.html

*If you're not familiar with the workings of the World Trade Organization (WTO), this article helps to explain the impact WTO rulings can have.*

AMPARA, Sri Lanka — Wild monkeys and Buddhist shrines outnumber any signs of industry, and rampaging elephants are not uncommon. The closest port lies seven hours away, down a rutted road. Yet here in the jungle of this small island nation in the Indian Ocean, the Daya Apparel Export Ltd. Factory and others like it churn out pants and shirts for American Eagle Outfitters, A-line skirts for the Gap and bras for Victoria's Secret.

"If I didn't have this job, we wouldn't have enough to eat," said 20-year-old Mohammed Ismail Mazeela, one of 2,000 women from surrounding villages who work at the plant. The $40 monthly wage supports her family in Sammamthurai village, where people walk trash-strewn lanes in bare feet. It buys the electricity powering the lone bulb in her shack, the food her mother cooks over the wood fire on their concrete floor, and schoolbooks for her sister's three children. "There is nothing else here."

Soon there may be even less. On Jan. 1 [2005], World Trade Organization rules governing the global textile trade will undergo their biggest revision in 30 years. The changes are expected to jeopardize as many as 30 million jobs in some of the world's poorest places as the textile industry uproots and begins consolidating in a country that has become the world's acknowledged low-cost producer: China.

### "A Rough Ride for Schwinn Bicycle: As the World Economy Shifted, So Did the Fortunes of an American Classic"

by Griff Witte, *Washington Post*, December 3, 2004 http://www.washingtonpost.com/wp-dyn/articles/A29737-2004Dec2.html

*We can give you only the first part of Griff Witte's article, but be sure to read the rest of it at* ***http://www.washingtonpost.com/wp-dyn/articles/A29737-2004 Dec2.html*** *It's worth the effort.*

MADISON, Wis. — In the glass atrium that marks the entrance to the Pacific Cycle company, the old and the new of the bicycle business are displayed side by side. Each is called the Schwinn Sting Ray, and each in its time has been a bestseller.

But the similarities end there. In the space of a generation, everything about the process of designing, producing and selling a Schwinn has changed.

The old Sting Ray broke the conventions of bicycle design, boasting a banana seat, high handlebars and extra-wide tires. In the 1960s and early '70s it became not only a symbol of middle-class aspirations, but also a provider of thousands of jobs that paid good wages with health and retirement benefits.

Today's model, which projects the rough look of a motorcycle, comes from China, where the average factory worker makes less than a dollar an hour. It is a symbol of a different sort — an illustration of how global economic forces and the sometimes clumsy responses of U.S. companies transformed middle-class jobs into low-wage work both at home and abroad.

In a nation that measures jobs in the tens of millions, changes to a few thousand barely register. But when multiplied across a wide range of industries, the rise and fall of companies such as Schwinn help explain why the economy has become less forgiving of workers who lack higher education or specialized skills.

"We're missing a big, important part of our society. Either everyone has to go to college or everyone has to have very low-paying jobs," said Richard Schwinn, part of the fourth and last generation to run the firm that bears his name. "I'm not sure that's a great balance."

The Schwinn Bicycle Co. went bankrupt in 1993 and sold off the brand. But at its peak two decades earlier, the Schwinn family oversaw a labor force of 2,000, the majority of whom never made it past high school. Several thousand more U.S. workers benefited from jobs at Schwinn dealerships, or in the steel and rubber factories that supplied parts.

Richard Schwinn, a large, bearded man with the bearing of a lumberjack, now oversees an empire of 17 at a small custom bike factory in rural Waterford, Wis.

About 75 miles away, in Madison, Pacific Cycle manages the Schwinn brand from a sleek office with just 80 workers. Pacific, part of a Canadian conglomerate, has a couple of hundred employees in California warehouses, taking in the bikes imported from the seven Chinese factories where most Schwinns are produced.

From California, the bikes fan out to mass merchants such as Wal-Mart. Once there, cashiers making less than $10 an hour ring up the latest Sting Ray at prices much cheaper than the original. Pacific sells more than a quarter of all bikes purchased in the United States, with just about 350 U.S. employees.

This is the outcome the Schwinn family had desperately sought to avoid. But like many companies struggling to decipher how American production and service workers fit in a globalized market, Schwinn erred badly. Industry insiders say the family's dogged but ultimately flawed determination to stay American-made contributed to its doom.

"They did a lot of things right over nearly 100 years," said Gary Coffrin, an industry consultant. "But at the end, there were a lot of things that caught up with them."

### "Is Wal-Mart Good for America?"

Public Broadcasting System, FRONTLINE broadcast, November 2004, correspondent Hedrick Smith **http://www.pbs.org/wgbh/pages/frontline/shows/walmart/**

*OK, this is a "hot potato," but there's just no way to focus on globalization without looking at how the relationship between producers and retailers has changed.*

"Wal-Mart's power and influence are awesome," [FRONTLINE correspondent Hedrick] Smith says. "By figuring out how to exploit two powerful forces that converged in the 1990s — the rise of information technology and the explosion of the global economy — Wal-Mart has dramatically changed the balance of power in the world of business. Retailers are now more powerful than manufacturers, and they are forcing the decision to move production offshore."

"Wal-Mart has reversed a hundred-year history that had the retailer dependent on the manufacturer," explains Nelson Lichtenstein, a professor at the University of California Santa Barbara. . . .

To understand the secret of Wal-Mart's success, Smith travels from the company's headquarters in Bentonville, Ark., to their global procurement center in Shenzhen, China, where several hundred employees work to keep the company's import pipeline running smoothly. Of Wal-Mart's 6,000 global suppliers, experts estimate that as many as 80 percent are based in China.

"Wal-Mart has a very close relationship with China," says Duke

University Professor Gary Gereffi. "China is the largest exporter to the U.S. economy in virtually all consumer goods categories. Wal-Mart is the leading retailer in the U.S. economy in virtually all consumer goods categories." . . .

When trade agreements were signed between the U.S. and China in the 1990s, bringing China into the World Trade Organization, American political and business leaders embraced the idea. China's 1.2 billion people were viewed as an enormous untapped market for American-made goods. The reality, experts say, is the opposite. China's exports to the U.S. have skyrocketed.

At a salary of only 50 cents an hour or $100 a month, Chinese labor is an unbeatable bargain for international business. And the Chinese government is doing everything it can to be sure the country's infrastructure supports the export business. Ten years ago Shenzhen's main port did not exist. Today it's on the verge of becoming the third busiest port in the world.

Wal-Mart estimates it imports $15 billion of Chinese goods every year and concedes that the figure could be higher — some estimates range as high as $20 or $30 billion. Company executives are quick to point out they have always scoured the globe for low cost suppliers to benefit the American consumer.

"We do depend on products from around the globe to draw our consumers into the stores," says Ray Bracy, Wal-Mart's vice president for federal and international public affairs. "We feel they need to have the best product, the best value, at the best price we can achieve."

Some experts contend Wal-Mart's "everyday low prices" are causing a clash between the interests of Americans as workers and the desires of Americans as consumers.

"If people were only consumers, buying things at lower prices would be just good. But people also are workers who need to earn a decent standard of living," says economist Larry Mishel of the Economic Policy Institute. "The dynamics that create lower prices at Wal-Mart and other places are also undercutting the ability of many, many workers to earn decent wages and benefits and have a stable life."

Economist Brink Lindsey of the Cato Institute sees it another way. "I think Wal-Mart is good for America," he says. "Wal-Mart is doing what the American economy is all about, which is producing things consumers want to buy . . . offering consumers a wide range of goods at rock-bottom prices. It is meeting the market test."

## "How Costco Became the Anti-Wal-Mart"

by Steven Greenhouse, *New York Times*, July 17, 2005

*Even in the tough, competitive world of discount retailing, there may be more than one way to succeed.*

ISSAQUAH, Wash. — Jim Sinegal, the chief executive of Costco Wholesale, the nation's fifth-largest retailer, had all the enthusiasm of an 8-year-old in a candy store as he tore open the container of one of his favorite new products: granola snack mix. "You got to try this; it's delicious," he said. "And just $9.99 for 38 ounces." . . .

But the piece de resistance, the item he most wanted to crow about, was Costco's private-label pinpoint cotton dress shirts. "Look, these are just $12.99," he said, while lifting a crisp blue button-down. "At [department stores], this is a $45, $50 shirt."

Combining high quality with stunningly low prices, the shirts appeal to upscale customers — and epitomize why some retail analysts say Mr. Sinegal just might be America's shrewdest merchant since Sam Walton.

But not everyone is happy with Costco's business strategy. Some Wall Street analysts assert that Mr. Sinegal is overly generous not only to Costco's customers but to its workers as well.

Costco's average pay, for example, is $17 an hour, 42 percent higher than its fiercest rival, Sam's Club. And Costco's health plan makes those at many retailers look Scroogish. One analyst, Bill Dreher of Deutsche Bank, complained last year [2004] that at Costco "it's better to be an employee or a customer than a shareholder."

Mr. Sinegal begs to differ. He rejects Wall Street's assumption that to succeed in discount retailing, companies must pay poorly and skimp on benefits, or must ratchet up prices to meet Wall Street's profit demands.

Good wages and benefits are why Costco has extremely low rates of turnover and theft by employees, he said. And Costco's customers, who are more affluent than other warehouse shoppers, stay loyal because they like that low prices do not come at the workers' expense. "This is not altruistic," he said. "This is good business."

## "My Outsourced Life"

A.J. Jacobs, *Esquire Magazine*, September 2005 **http://www.smartmoney.com/esquire/index.cfm?Story=20050909-outsource**

*"Outsourcing" or "offshoring" — whatever you want to call it — is no laughing matter, unless you're reading A.J. Jacobs' satirical piece in which he contracts out almost every aspect of his life to a pair of firms in India. One note of caution: The article contains a few "indelicate" words and phrases.*

It began a month ago. I was midway through "The World Is Flat," the bestseller by Tom Friedman. I like Friedman, despite his puzzling decision to wear a mustache. His book is all about how outsourcing to India and China is not just for tech support and carmakers but is poised to transform every industry in America, from law to banking to accounting. CEOs are chopping up projects and sending the lower-end tasks to strangers in cubicles ten time zones away. And it's only going to snowball; America has not yet begun to outsource.

I don't have a corporation; I don't even have an up-to-date business card. I'm a writer and editor working from home, usually in my boxer shorts or, if I'm feeling formal, my penguin-themed pajama bottoms. Then again, I think, why should *Fortune* 500 firms have all the fun? Why can't I join in on the biggest business trend of the new century? Why can't I outsource my low-end tasks? Why can't I outsource my life?

The next day I email Brickwork, one of the companies Friedman mentions in his book. Brickwork — based in Bangalore, India — offers "remote executive assistants," mostly to financial firms and health-care companies that want data processed. I explain that I'd like to hire someone to help with *Esquire*-related tasks — doing research, formatting memos, like that. The company's CEO, Vivek Kulkami, responds: "It would be a great pleasure to be talking to a person of your stature." Already I'm liking this. I've never had stature before. In America, I barely command respect from a Bennigan's maitre d', so it's nice to know that in India I have stature.

### "An Elder Challenges Outsourcing's Orthodoxy"

by Steve Lohr, *New York Times*,
September 9, 2004
http://select.nytimes.com/gst/abstract.html?res=F00D1FF93C540C7A8CDDA00894DC404482

*When Paul Samuelson talks, a lot of people still listen*

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 [September 2004] in a distinguished journal, cloaked in clever phrases and theoretical equations, but clearly aimed at the orthodoxy within his profession: Alan Greenspan, [former] chairman of the Federal Reserve; N. Gregory Mankiw, [former] 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 . . . .

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 . . . .

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."

## "Auto woes manufacture city's decline"

by Sharon Silke Carty, *USA Today*, January 11, 2006 **http://www.usatoday.com/money/autos/2006-01-11-ypsilanti-usat_x.htm**

YPSILANTI, Mich. — Look at a map of Ypsilanti and draw your finger along Ford Street and over to the Ypsilanti Automotive Heritage Museum, home to obscure cars once built here. Or circle around to Factory Street and Ford Lake, a man-made invention created when Henry Ford brought the promise of hydropower and middle-class wages to the city in the 1930s.

There's no denying Ypsilanti has a history deeply rooted in the auto industry. It was even, at one point, a booming little auto town — with a peak population of 29,500 in 1970. Now, after decades of declining employment in the auto sector, Ypsilanti's population is down about 25% to an estimated 22,200 in 2004. Its median household income is $28,000, 31% below the national average.

The question is: Can Ypsilanti survive long enough to turn into something else?

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. . . . [T]he problems it faces are indicative of those dogging much of the Rust Belt as the domestic auto industry consolidates in an effort to stay competitive with foreign automakers.

When plants close people move to find new jobs, surrounding businesses fail, and the overall tax base shrinks. Like Ypsilanti, many auto towns are searching for a new industry, if there is one, to replace the lost jobs. Many are shells of what they once were.

In Ypsilanti, three of 14 schools have closed. In some neighborhoods, rows of homes sit boarded up. In others, meticulously preserved Victorians sit next to crumbling houses.

Ypsilanti's police force is 27% smaller than in 1997, and the recreation department is mostly closed. The city has talked about filing for bankruptcy but worries that a state-appointed receiver would sell off assets, such as the city's snowplows, which no town in Michigan should be without.

But something needs to be done. "We're broke. We're cut to the bone. There's no place else to cut that really won't be felt," says Cheryl Farmer, Ypsilanti's mayor for 10 years.

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***One optimistic note in the story's final paragraphs . . .***

Still, the region has maintained a reputation for strong colleges and universities. Ypsilanti is home to Eastern Michigan University, and the University of Michigan is less than 10 miles away.

Folks like restaurant owner [Linda] French hope access to the universities will change Ypsilanti into a hip urban center. "We weren't always a factory town," she says. "We're in historical times now. We're seeing factories close, but Ypsilanti might end up being better off."

## "Small World"

by Bill McKibben, *Harper's Magazine*, December 2003

*Distances are shrinking, boundaries are blurring, and the world's economy is becoming more integrated with each passing day. But there are also indications that people are rediscovering the virtues and pleasures of locally produced products and services.*

*Writer Bill McKibben visited the town of Barre in his home state of Vermont and came away with a story that looks at that trend by focusing on two thriving local businesses: (1) a radio station, WDEV, that offers its listeners an eclectic mix of programming — auto racing from the local track, a bird-watching hour, Music to Go to the Dump By, girls high school basketball, college hockey, Dinner Jazz, a conservative talk show, a liberal talk show, and (2) the Farmer's Diner, where "something like 80 percent of the food it serves was raised within 60 miles of the kitchen."*

Forget the red states and the blue states. WDEV [in Waterbury, Vermont] exists in a kind of purple state. Many parts of its schedule sound like things you can hear elsewhere. If you've got the new satellite radios, you can get bluegrass twenty-four hours a day and nineteen flavors of jazz. Modern radio stations aim for a particular niche — say, thirty-five-year-old males who want sports around the clock. But it's a rare place in our society where Thelonius Monk and stock-car racing coexist. It's radio that actually reflects the reality of local life, and it seems very strange because it's all but disappeared everywhere else.

A couple of miles downhill from Thunder Road, on the slightly tired main street of Barre, Tod Murphy opened up a diner . . . right next to the hardware store. Ham and eggs, breakfast all day, bottomless cup of coffee. A local joint. But the Farmer's Diner is maybe the most local joint in the whole United States — something like 80 percent of the food it serves was raised within sixty miles of the kitchen. In a country where the average forkful of dinner travels 1,500 miles to reach your lips, this makes Murphy's diner perhaps the most interesting restaurant in America.

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. . . . I began to wonder if maybe "local" really is what comes next — whether as the globalized world begins to fray socially and environmentally and even economically, people might start wanting to shorten their supply lines. Energy that comes from a windmill on the ridge instead of an oil tanker from the Gulf, say. . . . The momentum in the direction of globalization seems too powerful to buck, the economic logic unmatchable. But in a region where jobs are draining away, and where an ethic of self-reliance remains a dim, vestigial, but honored memory, it seems at least an outside possibility.

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An economist would argue that we've chosen this world — that if we didn't want the Sysco truck unloading frozen dinners into the back door of the family-casual chain dining house, we wouldn't go there. That if we wanted to listen to local radio, local radio would ipso facto exist. And there's plenty of truth in all that — by and large we have picked (with the assistance of immense quantities of advertising) the cheapest, the easiest, the saltiest, the greasiest. Something in dirty talk [radio] appeals to many of us, and community has often seemed like more work than it's worth. Our choices have in some ways built our world. On the other hand, it's hard to test whether these are the choices we really, or still, want to make. If most every radio station in your town is owned by some big broadcaster, you need millions of dollars to buy a frequency, if indeed one is even open. If your choice of restaurants is confined to twenty places with a loading ramp at the back for the tractor-trailer, then it's harder to make a statement of your desires.

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Look — we live in a world where [big chains], with their unbelievable efficiency, have managed to erode away most of what were once local economies — "Low Prices Always" might as well replace "In God We Trust." So it's a stretch to imagine that a really good hot turkey sandwich might matter — that the pendulum might be poised to swing back the other way. But it's sweet to imagine it too.

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When you're local, it's harder to be a complete jerk. ■

# Globalization & Policymaking

*Richard W. Fisher, president of the Federal Reserve Bank of Dallas, is a keen observer of globalization.*

*In November 2005, Mr. Fisher delivered a speech in Cambridge, Massachusetts, on globalization and monetary policy. And in December 2005, in Philadelphia, Pennsylvania, he delivered remarks on globalization and government policy.*

*We share with you here major portions of both speeches, and we have provided links to the complete text for each.*

## Globalization and Monetary Policy

Richard W. Fisher, President, Federal Reserve Bank of Dallas
Warren and Anita Manshel Lecture in American Foreign Policy
Harvard University, Cambridge, Mass., November 3, 2005
Complete speech: **http://www.dallasfed.org/news/speeches/fisher/fs051103.html**

The literature on globalization is large. The literature on monetary policy is vast. But literature examining the combination of the two is surprisingly small.

If you Google "globalization" and "monetary" and "policy," you will turn up more than 2 million references. However, a search of scholarly articles with the same word combination turns up only 30,700. If you narrow your quest to the exact word combination "globalization and monetary policy," you get a mere 39 citations. Limiting the word combination to the title of an article, you will find a mere two articles.

So, at a minimum, this is going to be a rare speech! I hope it will prove insightful.

Tom Friedman's popular book *The World Is Flat: A Brief History of the Twenty-First Century* doesn't have a single entry on "money," "monetary policy" or "central banking." And in Michael Woodford's influential book *Interest and Prices: Foundations of a Theory of Monetary Policy*, the word "globalization" does not appear in the index. Nor do the words "international trade" or "international finance."

What gives? Is the process of globalization disconnected from monetary policy? Is the business of the central bank totally divorced from globalization?

I think not. I believe globalization and monetary policy are intertwined in a complex narrative that is only beginning to unfold. This isn't *To the Lighthouse*. It may be that the process of globalization might never end. But I believe it does have a plot, which I will turn to momentarily.

Where does monetary policy come into play in this world? Well, consider the task of the central banker, seeking to conduct a monetary policy that will achieve maximum sustainable non-inflationary growth.

Consider, for example, the experience of former Federal Reserve

Governor Larry Meyer, articulated in his excellent little book *A Term at the Fed*. It was one of the first books I read this winter in Cambridge as I prepared for my new job. In it, you get a good sense of the lexicon of monetary policy deliberations. The language of Fedspeak is full of sacrosanct terms such as "output gap" and "capacity constraints" and "the natural rate of unemployment," known by its successor acronym, "NAIRU," the non-accelerating inflation rate of unemployment. Central bankers want GDP to run at no more than its theoretical limit, for exceeding that limit for long might stoke the fires of inflation. They do not wish to strain the economy's capacity to produce.

One key capacity factor is the labor pool. There is a shibboleth known as the Phillips curve, which posits that beyond a certain point too much employment ignites demand for greater pay, with eventual inflationary consequences for the entire economy.

Until only recently, the econometric calculations of the various capacity constraints and gaps of the U.S. economy were based on assumptions of a world that exists no more. Meyer's book is a real eye-opener because it describes in great detail the learning process of the FOMC members as the U.S. economy morphed into the new economic environment of the second half of the 1990s. At the time, economic growth was strong and accelerating. The unemployment rate was low, approaching levels unseen since the 1960s. In these circumstances, if you believed in the Phillips curve and the prevailing views of potential output growth, capacity constraints and the NAIRU, inflation was supposed to rise. That is precisely what the models used by the Federal Reserve staff were saying, as was Meyer himself, joined by nearly all the other Fed governors and presidents gathered around the FOMC table. Under the circumstances, they concluded that monetary policy needed to be tightened to head off the inevitable. They were frustrated by Chairman Greenspan's insistence that they postpone the rate hikes they were proposing, yet perplexed that inflation wasn't rising. Indeed, inflation just kept on falling.

If the advice of Meyer and other devotees of the Phillips curve, capacity constraints, output gaps and NAIRU had prevailed, the Fed would have caused the economy to seriously underperform. According to some back-of-the-envelope calculations by economists I respect, real GDP would have been lower by several hundred billion dollars. Employment gains would have been reduced by perhaps a million jobs. The costs of not getting these critical calibrations right would have been huge.

Now, how was Greenspan able to get it right when other very smart men and women did not? Well, we now recognize with 20/20 hindsight that Greenspan was the first to grasp the fact that an acceleration in productivity had begun to alter the traditional relationships among economic variables.

I want to depart briefly from this story line to tell you what I have learned by watching this remarkable man work for the short time I have had that privilege. One of the attributes that makes Greenspan unique is something my wife wishes I would do better: He is a superb listener. He understood the data and the modeling techniques of the Fed's research staff. But he was also constantly talking—and listening—to business leaders. And they were telling him what he knew from years of consulting and sitting on various boards: They were simply doing their job of seeking any and all means of earning a return for their shareholders. At the time, they were being enabled by new technologies that enhanced productivity. The Information Age had begun rewriting their operations manuals. Earnings were being leveraged by technological advances. Productivity was surging.

It is important to listen to the operators of our business economy. We have millions of experienced managers and decision makers in the private sector. This may be our greatest competitive advantage, for no other population has the length and depth of experience that U.S. business operators do. They are the source of the mighty economic machine that we call America, in which we produce some $12 trillion in economic output. And just as they did by inventing new technology—and, then, using that technology—America's business managers have taken advantage of the phenomenon of globalization. Our business managers are the nerve endings in Adam Smith's invisible hand, stretching the fingers of capitalism into every corner of comparative advantage worldwide.

Just consider what the fall of the Soviet Union, the implementation of Deng Xiaoping's "capitalist road" in China, and India's embrace of market reforms mean to a business operator. Consider labor alone. In the early '90s, the former Soviet Union released millions of hungry workers into the system. China joined the World Trade Organization at the turn of the century and injected 750 million workers into play. And now India, with over 100 million English-speaking workers among its 1 billion people, has joined the game. What does an American manager—paid to enhance returns to shareholders by growing revenues at the lowest possible costs—do? Because labor accounts for, on average, about two-thirds of the cost of producing most goods and services, a business manager will go where labor is cheapest. She will have a widget made in China or Vietnam, or a software program written in Russia or Estonia, or a center for processing calls or managing a back office set up in India.

Let me tell you of one eye-opening experience. About two years ago, I was in London on business for Kissinger McLarty. I received a call from the head of Japan's equivalent of the Business Roundtable, the Keidanren, asking me to "pop over tomorrow to give a luncheon and dinner speech." They made an offer I couldn't refuse, and I said I would be glad to do it if they could arrange the flights. They booked me on Virgin Air and arranged for a car to take me to Heathrow. At the appointed time, the car didn't show up. So I called the number I had been given. The call was answered by a woman with a frightfully British accent. When I asked, "Could you kindly tell me where my car is, ma'am?" she deftly shifted to a Southwestern American accent and said, "Now don't you worry. It is five minutes away. Ah apologize for the delay. Have a nice flight."

I said, "Well, hold on a minute. You answered this call in a British accent but once I spoke, you shifted to a Texas accent. Who are you? Where are you?"

"Well," she answered, "I am a call center operator in Bangalore."

"Have you ever been to the United States?" I asked.

"Oh, no, sir. But I can tell that you are from Arkansas, Texas or New Mexico."

"And how do you learn to speak like me?"

"Well, sir, for people like you, we watch a tele show called *Walker, Texas Ranger*."

"And what if I were from Boston?"

"Ah, for those people we watch *Cheers*."

It may seem like a small matter that a Japanese firm employed a worker in India to track a car by GPS in London and mimic a voice from Texas. But globalization impacts the conduct of business—and therefore the expansion of our productive capacity and the pricing mechanism of labor and other inputs—so much more profoundly.

Let me return home to Harvard once more and read you three quotes from Joseph Schumpeter, who taught here from 1932 until 1949, and I think you will get the picture.

First, from *Capitalism, Socialism, and Democracy*: "The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates."

From that same page: "The opening up of new markets, foreign or domestic, and the organizational development from the craft shop and factory...illustrate the same process of industrial mutation...that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of creative destruction is the essential fact of capitalism. It is . . . what every capitalist concern has got to live in."

And from volume 1 of Schumpeter's *Business Cycles*: "A railroad through new country, i.e., a country not yet served by railroads, as soon as it gets into working order upsets all conditions of location, all cost calculations, all production functions within its radius of influence; and hardly any 'ways of doing things' which have been optimal before remain so afterward."

String the key operative phrases of those three citations together and you get the plot of this story, the plot of globalization: "The opening up of new markets, foreign or domestic. . . revolutionizes the economic structure, . . . destroying the old one, . . . creating a new one. . . . [It] upsets all conditions of location, all cost calculations, all production functions, . . . and hardly any ways of doing things which have been optimal before remain so afterward."

The master of creative destruction of syntax, Yogi Berra, put it more eloquently: Once you open new markets, "History just ain't what it used to be."

The destruction of communism and the creation of vast new sources of inputs and production have upset all the calculations and equations that the very best economics minds, including those of the Federal Reserve staff—and I consider them the best of all—have used as their guideposts. The old models simply do not apply to the new, real world. This is why I think so many economists have been so baffled by the length of the current business cycle and the non-inflationary prosperity we have enjoyed over the past almost two decades.

You could sense something was wrong with the econometric equations if you listened to the troops on the ground, fighting in the trenches of the marketplace. This is what Chairman Greenspan does so well. And, though I am no Greenspan and never will be, this is what my colleagues and I at the U.S. Trade Representative's office did negotiating market-opening trade rounds with China, Vietnam, Mexico, Brazil and others. It is what my colleagues and I at Kissinger McLarty did while advising dozens of U.S. companies seeking entry into China and the former Soviet satellites and India and Latin America. It is what my colleagues and I on the FOMC do by making dozens upon dozens of calls to CEOs, COOs and CFOs of businesses, large and small, every month to prepare for FOMC meetings. We are simply observing managers at work expanding the capacity of our economy, expanding the gap between what their previously limited resources would allow them to produce and what their newly expanded globalized, technologically enhanced reach now allows them to produce.

From this, I personally conclude that we need to redraw the Phillips curve and rejig the equations that inform our understanding of the maximum sustainable levels of U.S. production and growth.

Let me illustrate the point by citing another fine writer, Greg Ip. In yesterday's *Wall Street Journal*, he noted that the "U.S. economy grew at a 3.8% annual rate in the third quarter [of this year], its eighth consecutive quarter at about that pace. That's above what most economists consider the economy's potential growth rate—that is, what it can produce with existing capital and labor."

How can economists quantify with such precision what the U.S. can produce with existing labor and capital when we don't know the full extent of the global labor pool we can access? Or the totality of the financial and intellectual capital that can be drawn on to produce what we produce?

As long as we are able to hold back the devil of protectionism and keep open international capital markets and remain an open economy, how can we calculate an "output gap" without knowing the present capacity of, say, the Chinese and Indian economies? How can we fashion a Phillips curve without imputing the behavioral patterns of foreign labor pools? How can we formulate a regression analysis to capture what competition from all these new sources does to incentivize American management?

Until we are able to do so, we can only surmise what globalization does to the gearing of the U.S. economy, and we must continue driving monetary policy by qualitative assessment as we work to perfect our quantitative tool kit. At least that is my view.

Now that you have some insight into the frustrations central bankers have with how globalization impacts their deliberations, let me turn to how their actions impact globalization.

Remember my description of the job of the Fed, or any other central bank, as maintaining the cardiovascular system of the economy? A healthy cardiovascular system enables the brain and propels the muscles of production. The quantity of the money supply is critical to economic success, as is the quality. If the productive forces and employers of the world are threatened by, say, the virus of inflation due to ill-implemented monetary policy, they will be disabled from achieving maximum efficiency.

The cost of capital is a critical variable in any business operation. The lower the cost in real terms — net of inflation—the better.

Get to a Bloomberg terminal and look across the world. Interest rates have been trending downward to post–World War II lows as inflation has trended downward. Over the past few years there has been a noticeable convergence of rates all along the yield curve—from the shortest term you can borrow money to the longest. (Indeed, due to increasing confidence in the determination and ability of central banks to hold inflation at bay, the term "long" has now been stretched out to 50 years.) This is true not just for the major economies. As a proxy for what this means to business borrowers worldwide, consider some sovereign credits. Greece, backed by the euro, borrows funds of 10-year maturity at 3.7 percent. Poland can borrow 10-year money at 5.2 percent. And here is my poster child for what I consider the miracle of globalized money markets. Let me read to you from the *Financial Times* of October 28: "Vietnam yesterday raised $750 million with . . . a dollar denominated . . . 10-year bond. Investors put in orders totaling $4.5 billion, six times the amount on offer. During trading in New York . . . the bond . . . was priced to yield 7.125%." When I was at Harvard, we were killing the Vietnamese. Now we are financing them, and at low rates.

I seriously doubt that had central bankers here or elsewhere in the world not managed their affairs in a manner that discourages inflationary expectations, this would be anywhere near possible. You cannot have the frenetic progress Tom Friedman describes in his book without the well-functioning, reliable monetary regimes central banks have been sustaining.

This is the great responsibility of the strange species known as central bankers. It is an especially intense responsibility for the Federal Reserve, as the central bank of the largest economy in the world, which prints the world's most utilized currency. One cannot make monetary policy without being aware of the forces of globalization acting upon our

economy. Nor can one be oblivious to the need for us to conduct our policy without an awareness of how what we do impacts markets, and therefore, economic potential, worldwide.

A few weekends ago, I went to College Station, Texas, to watch Texas A&M play Baylor. One of the A&M regents tried to explain a coach's decision that I had questioned. I couldn't understand the logic after several tries. So my friend said, "Look, Harvard boy, let me lay it on you in Aggie Latin: Bubbus, sed possum explicare. Non sed possum comprehendere. Bubba, I can explain it to you, but I can't understand it for you."

This evening, I have done my best to explain that there is a connection between globalization and monetary policy. I hope you take what I have said and come to understand what it means.

The night is long. So, for the sake of ideological balance, in closing let me evoke Keynes and his observation that in the long run, we are all dead—a proposition that still holds in a globalized world. Bibamus, moriendum est. Death is unavoidable; let's call it quits and have a drink.

## Globalization and Government Policy

Richard W. Fisher, President, Federal Reserve Bank of Dallas
Remarks at the Fifth Annual Federal Reserve Bank of Philadelphia Policy Forum, December 2, 2005
Complete speech: **http://www.dallasfed.org/news/speeches/fisher/fs051202.html**

Globalization describes the economic reality of our times. In simplest terms, it means a nation's economic potential is no longer defined by political and geographical boundaries. Indispensable to the concept is factor mobility. The globalizing world we live in is one in which the goods, services, capital, labor and ideas that propel economic growth are increasingly free to migrate to where they are most valued and can work together most efficiently, flexibly and securely. These key factors of production avoid bureaucratic restrictions that lock them into outmoded methods and organizations and intrusive governments that limit their ability to adapt to a rapidly changing economic environment. They look for maximum profitability in returns on capital and the lowest tax burden on the sweat of the brow. In short, they constantly search for the environment with the fewest obstacles to success and—this is a point we must always remember—they are increasingly free to move to more welcoming environments.

Economic policies, of course, can have a big influence on decisions about where it is best to do business. A globalizing world means governments, national as well as regional and local jurisdictions, are forced to compete to attract and to hold these increasingly mobile factors of production.

U.S. business leaders have come to grips with the inevitability of global competition. Now, our policymakers must prove they can do the same.

I think monetary authorities around the world have gotten the message. They have achieved a new discipline, thanks in part to the competition created by globalization. Open financial markets allow investors to seek countries with stable money and shun those places where the value of their capital will be eroded. A clear result of globalization has been inflation rates converging at lower levels in North America, Asia and Europe. When it comes to accommodating inflation, central bankers everywhere have become, to quote my late, great father-in-law, Congressman Jim Collins, tighter than a new pair of shoes.

Has globalization brought a similar disciplining force to fiscal policy? It is hard for me to stand here today, among eminent scholars who delivered chapter and verse on America's fiscal profligacy, and tell you we are seeing better fiscal policies. Yet, I believe that globalization is having a beneficial impact on fiscal decisionmaking and that, while the United States is hardly virtuous on this front in an absolute sense, it is in better shape than most of its competitors.

Let me first turn to the discipline imposed on fiscal policy by global forces.

Take taxes. In a world where capital moves across borders more freely than ever, globalization heightens tax competition among nations, just as it does among states in this country. Indeed, we are seeing the average tax rate come down in the world's most open economies as nations compete for productive resources. Among OECD nations, the average top corporate tax rate fell from 38 percent in 1996 to 31 percent in 2002. Estonia has instituted a flat tax. Japan has learned through painful experience what it means to raise taxes. Poland and Germany are in the midst of tectonic political battles in which tax issues loom large. And China rarely, if ever, actually collects significant taxes from the corporate sector. In today's world, I doubt you can earn many brownie points, let alone raise more revenues, by increasing taxes on investors who are free to roam.

One would think that globalization would lead to similar discipline on the spending side. In theory, increasingly mobile companies and workers should not be fooled by a government that promises ever-growing spending not paid for by existing or new revenue streams. They should anticipate corrective measures down the road and adjust their behavior accordingly—at least if the theory of rational expectations has merit.

When people fully understand the economic environment in which policy is being made—that is, when they are rational—policymakers' power to manipulate the business cycle for short-term political gain is mitigated. In theory, fiscal authorities who face rational economic agents should find they can't use deficit spending to stimulate GDP because people will simply save more in response to today's increased public debt, anticipating tomorrow's higher tax bills.

But the deficit-reducing pressures anticipated by theory have yet to arrive in reality.

The United States continues to be a preferred destination for foreign capital, the most mobile of factors. These flows of international savings have made it easier—or at least less painful—to finance our deficits at low interest rates. Without capital from overseas, the growth of government spending might have crowded out the growth of household spending. Readily available foreign money has helped finance our surge in consumption spending and housing investment.

Why is this? I will offer one suggestion, drawing on my past experience as a market operator and putting on my old hat as an asset allocator: Other potential destinations for significant investment are actually doing worse than we are in terms of fiscal policy.

OECD data, which cover state and local governments as well as national budgets, show our public sector in the red at a projected 3.7 percent of GDP this year. In contrast, Japan is at 6.5 percent, Italy at 4.3 percent and Germany at 3.9 percent. France is only marginally better at 3.2 percent, according to the OECD. The assumptions behind these numbers may be a bit dodgy: For example, it is not clear whether the OECD data capture the impact strong U.S. growth is having this year on the federal deficit and on state and local revenues. A similar revenue swing is clearly not occurring in the budgets of the lander and central government in Germany, or in France. French Finance Minister Thierry Breton's straightforward revelations just a few days ago make it clear that his country's fiscal predicament is far worse than previously reported.

Here is the point: In terms of investors looking to allocate their capital, and the impact they have on the price of money, you cannot think of U.S. fiscal policies in strict isolation from what is happening in other countries. ■

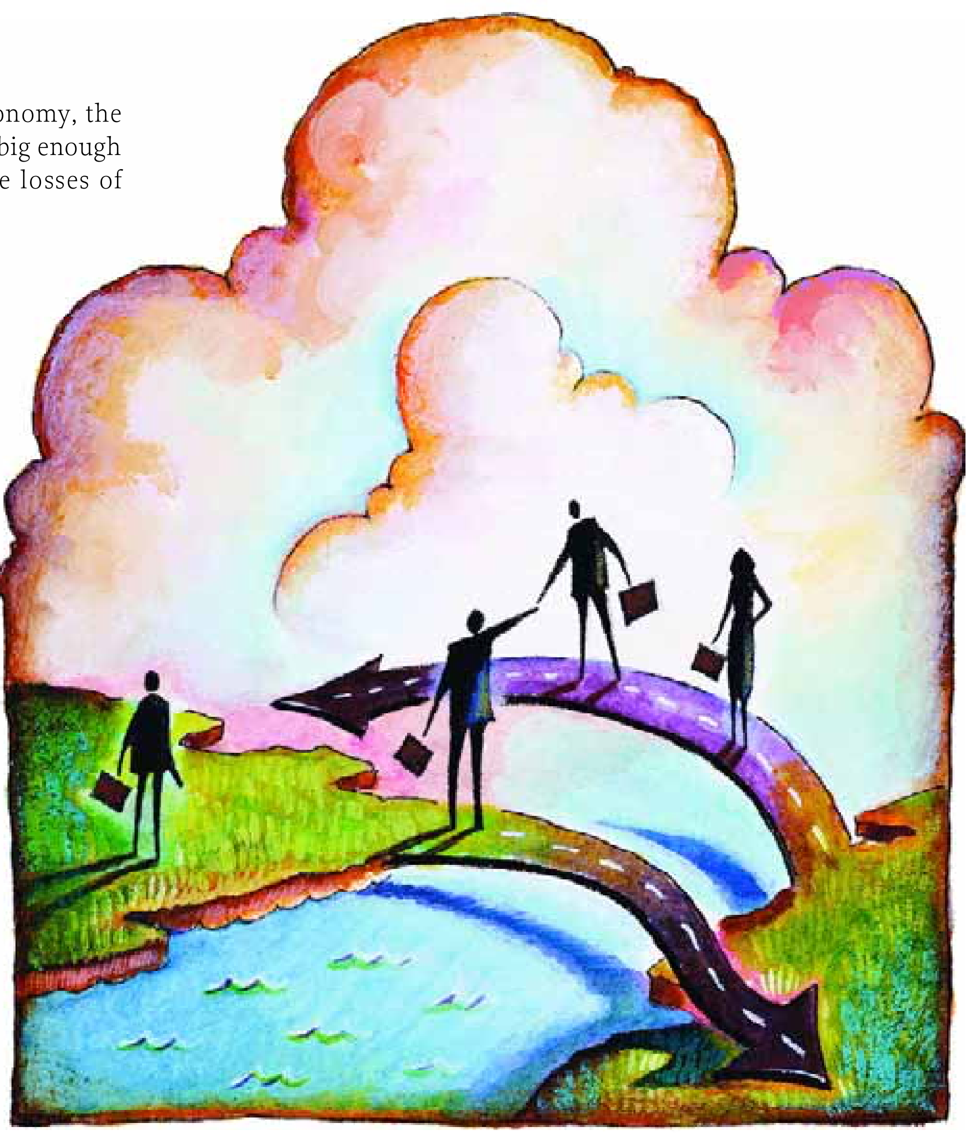
# What do you think?

## A Globalization Survey

**This survey has no right or wrong answers.**

1. Education won't necessarily guarantee you a good job, but without it your chances of finding a good job in the global economy are minimal.
__ Strongly agree
__ Agree somewhat
__ Disagree somewhat
__ Strongly disagree

2. In the transition to a global economy, the gains of American winners will be big enough to more than compensate for the losses of those who don't fare as well.
__ Strongly agree
__ Agree somewhat
__ Disagree somewhat
__ Strongly disagree



3. Economist Larry Mishel of the Economic Policy Institute: "The dynamics that create lower prices at [giant discount retailers] for American consumers are also undercutting the ability of many, many workers to earn decent wages and benefits and have a stable life."
__ Strongly agree
__ Agree somewhat
__ Disagree somewhat
__ Strongly disagree

4. American consumers have a responsibility to press for better working conditions in offshore factories owned by American companies.
__ Strongly agree
__ Agree somewhat
__ Disagree somewhat
__ Strongly disagree

5. Two products of comparable quality: one is American-made, the other is made offshore. How much more would you be willing to pay for the American-made product?
__ 20 percent
__ 10 percent
__ 5 percent
__ not a penny more

6. Do the rest of us have a responsibility to help when American workers lose their jobs because their companies move offshore?
__ Definitely
__ In some cases
__ Probably not
__ So, why is this my problem?

7. Thomas Friedman writes, "Here is the dirty little secret that no CEO wants to tell you: they are not just outsourcing to save on salary. They are doing it because they can often get better-skilled and more productive people than their American workers." What do you think?
__ Absolutely!
__ Probably more true than not
__ Not sure
__ No way!

8. Friedman again: "There is no sugar-coating this: in a flat world, every individual is going to have to run a little faster if he or she wants to advance his or her standard of living." What do you think?
__ I've got my running shoes on, and I'm ready to go.
__ Probably true
__ Not sure
__ It's just not worth it

9. Global competition will force the United States to cut back on environmental protections and workplace safety regulations.
__ Strongly agree
__ Agree somewhat
__ Disagree somewhat
__ Strongly disagree

10. Michael Cox and Richard Alm: "Trade is the great generator of economic well-being. It enriches nations because it allows companies and workers to specialize in doing what they do best. Competition forces them to become more productive. In the end, consumers reap the bounty of cheaper and better goods and services."
__ Strongly agree
__ Agree somewhat
__ Disagree somewhat
__ Strongly disagree

# Additional RESOURCES

**Lesson Plans on Global Economics from *New York Times* Web Site**
http://www.nytimes.com/learning/teachers/lessons/econ.html

**Special Report: Globalisation**
http://www.guardian.co.uk/globalisation/0,7368,408592,00.html
Dozens of articles on almost every aspect of globalization on Guardian Unlimited, the web site of the British newspaper formerly known as *The Manchester Guardian*

**Yale Global Online**
http://yaleglobal.yale.edu/index.jsp
The online edition of a publication from the Yale Center for the Study of Globalization. Articles on a wide range of issues related to globalization.

**The Buck Institute of Education**
http://www.bie.org/pbe/r_greatawakening.php
Links to resources on international trade

**Trade Ruler**
http://nobelprize.org/economics/educatioal/trade/index.html
"As the Supreme Ruler of an island you want the country to prosper. By engaging in international trade you can achieve this goal." That's the introduction to *Trade Ruler*, a fun game/simulation on Nobelprize.org — the web site of the people who bring you the Nobel Prize. Bonus Features: Two very good articles on international trade.

**What D'Ya Know: Lifetime Learning in Pursuit of the American Dream**
For most of us, education will be the key to finding a place in the global economy. The essay in the 2004 Annual Report from the Federal Reserve Bank of Dallas makes exactly that point: http://www.dallasfed.org/fed/annual/2004/index.html

**10 Benefits of the WTO Trading System**
http://www.wto.org/english/thewto_e/whatis_e/10ben_e/10b00_e.htm

**The World Economic Forum**
http://www.weforum.org/
An independent international organization committed to improving the state of the world by engaging leaders in partnerships to shape global, regional and industry agendas. Incorporated as a foundation in 1971, and based in Geneva, Switzerland, the World Economic Forum is impartial and not-for-profit; it is tied to no political, partisan or national interests. The Forum is under the supervision of the Swiss Federal Government.

**Rise of Industrial America, 1876-1900**
Library of Congress, American Memory Collection
http://memory.loc.gov/learn/features/timeline/riseind/riseof.html
Includes a section on the New England shoe industry
http://memory.loc.gov/learn/features/timeline/riseind/work/shoes.html

**"China: Migrants, Economy"**
*Migration News*
University of California-Davis
http://migration.ucdavis.edu/mn/more.php?id=3079_0_3_0

**Strong Dollar, Weak Dollar: Foreign Exchange Rates and the U.S. Economy**
Federal Reserve Bank of Chicago
http://www.chicagofed.org/consumer_information/strong_dollar_weak_dollar.cfm#top
Let's see. If I'm traveling to a foreign country, a weak dollar is bad because my dollars won't go as far. But maybe not, because the dollar isn't always weak or always strong against all currencies.

Confused? You have lots of company. Few things are more puzzling to Americans than questions that deal with foreign currency and exchange rates. Fortunately, the Federal Reserve Bank of Chicago has an online publication — *Strong Dollar, Weak Dollar: Foreign Exchange Rates and the U.S. Economy* — that covers almost everything you want to know — and in fairly simple language.

# Maybe it's time

The last time we updated our mailing list was 1986 . . .

• Ronald Reagan was in his second term.
• *Diff'rent Strokes* and *The Love Boat* were in their final seasons.
• Ferris Bueller was taking a day off.
• Microsoft was going public at $21 a share.
• And Apple's new Mac Plus (with one megabyte of RAM!) was selling for $2,600.

We're thinking it might be time for another update.

So — If you would like to keep receiving *The Ledger*, please complete the attached card and return it to us.
(Yes, *The Ledger* is still free of charge.)

If you don't return the card, we'll assume you no longer wish to receive *The Ledger*.

And if you know people who would like to be on our mailing list, tell them to contact us at:
http://www.bos.frb.org/education/ledger/ledgerorder.htm

# In Our Next Issue

**Rolling with the Punches:**
**How One Massachusetts City Has Coped with Economic Change**

Quincy, Massachusetts has seen it all. Two U.S. presidents were born there and lie buried next to one another in the basement of First Parish Church in Quincy Center. America's first railway hauled granite blocks from Quincy quarries to the site of the Bunker Hill Monument. Quincy-built ships helped to win two world wars, and payroll money from the Fore River Shipyard created a thriving downtown retail center once known as Shopperstown, U.S.A. But all that is in the past, and Quincy is now trying to find its place in the 21st century economy.