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OFFSHORE OUTSOURCING:
ONE CAUSE OF THE IMBALANCE IN THE U.S. BALANCE OF PAYMENTS

While offshore outsourcing by corporations of the **U**nited **S**tates (US) has been one of the planks of the political platforms of the Presidential hopefuls – President George W. Bush and Senator John Kerry – with claims that they will concoct a method to reverse the process in order to bring the jobs back home, actually, if that were to take place, it would, without question, be a cause of grave concern to the US Federal Reserve Board – because it would be inflationary in the extreme.

The die is cast; one cannot back the clock of progress.

The US continues to lose jobs in certain southern states, especially in the garment industry and the textile industry, simply because other countries, such as the People's Republic of China (PRC), Taiwan, the Philippines, South Korea, and so on can produce similar products, which are as good as, if not better than those produced in Continental US, and at much cheaper prices.

If the US Government were to ban imports of Chinese-produced shirts, trousers, jackets, piece goods etc, it would mean that the US consumer would be forced to purchase his garments/textiles from the domestic market at much higher prices.

This would result in labour, making heavy demands on Management for higher wages and salaries in order to be compensated for the higher costs, being charged in the High Street.

This would result in inflation.

Clearly, therefore, the US economy is dependant on imports of certain goods and services in order to hold down inflation in The Land of The Free and The Homes of The Brave.

And this is good for the largest single economy of the world.

Offshore outsourcing by US industry is one of the causes for the current record level of the trade deficit, however.

It will continue to be so, too.

The US trade deficit cannot be explained, simply by stating that the US is spending more than it is earning and that that is the reason that the Treasury is facing bankruptcy (which it is not, by the way).

In The Beginning, There Was …

Offshore outsourcing, as it is popularly known, today, probably, started to take root with the passing into law of The NAFTA (The **N**orth **A**merica **F**ree **T**rade **A**greement) about one decade ago.

The NAFTA permitted, indeed encouraged, a shift of certain US industries, south of the border into Mexico, where labour was plentiful and relatively cheap, compared with demands by labour in the US.

But, today, offshore outsourcing has extended far beyond Mexico and other South American countries and has reached India, the PRC, and a host of other Far East Asian countries.

The proliferation of offshore outsourcing by US industry has resulted in US products, first being shipped overseas and, then, returned in a different form with value added.

Hence the value of US imports exceeds the value of US exports.

And the resultant effect is a record-high trade deficit, estimated to be in the neighbourhood of about $US600 billion for the Current Fiscal Year.

The rapid development of offshore outsourcing, as well as industrial cooperation between contracting partners on other Continents, has sharply increased income elasticity with regard to US imports.

This is easily provable because, whereas, traditionally, the ratio of import growth was about 1.70 times the growth of the US **G**ross **D**omestic **P**roduct (GDP)*, today, it is about 2.50 times … and rising.

*** Gross Domestic Product = The Total Value of Goods and Services, Produced in a Country over a Period of Time**

<u>The US Balance of Payments</u>

The US balance of payments has been described variously by certain biased parties as being the legacy of President George W. Bush, who, through his alleged ineptitude, has bankrupted the country by spending more than the country has been earning.

This is not, exactly, the case.

In terms of the GDP, the US trade deficit is about 5.30 percent, today.

The record-high, US trade deficit is viewed, internationally, as being negative for the largest economy of the world.

This is likely to be proved to be fallacious in the fullness of time.

Of purported concern to opponents of the current US Administration are:

1. Rising foreign debt, which could create financial difficulties in time;

2. The US dollar, which will have to be depreciated, either de jure or de facto, in order to cut into the ever-widening trade deficit; and/or,

3. Foreign investment, which will start to wane, with funds, formerly earmarked for investment in the US, being diverted to some other country or countries.

The current trade deficits cannot go on forever, one is told.

But, is that correct?

Does one just accept that bland statement as being sacrosanct?

What is an undeniable fact is that, internationally, the US trade deficit does not seem to have affected people's confidence, either in the US economy or in the US dollar's preferred position as the *'reserve currency'* of the world.

The single currency of the European Union, the euro, is, still, not a patch on the US dollar as a reserve currency, and it is unlikely that it will rise to such prominence during this decade.

The US dollar's international role as the preferred reserve currency causes the US Current Account deficit to swell due to:

a. The inflow of monetary reserves to the US, brought about by Central Banks of other countries due to the normal accumulation of these reserves, especially in countries, enjoying Current Account Surpluses, such as Japan; and,

b. The interventions on foreign exchange markets by Central Banks of other countries, which are desirous of maintaining their country's currency parity, within a certain range, with the US dollar, with Japan's Bank of Tokyo, being one of the best examples of this over the past decade.

The international role of the US dollar as the preferred reserve currency, of course, has its negative side, also, because it is, after all, hegemonic.

One of the main ideas behind the establishment of the euro was an attempt to break the back of the US dollar's position as the preferred reserve current of the world.

But that will take some time to achieve, it appears, if at all.

This is, also, a self-evident truth because statistics indicate that about 65 percent of the international reserves of the world are denominated in US dollars.

Certainly, international investors continue to pour money into US investments; and, these international investors appear to be unperturbed by the record-high trade deficit of the US.

That must be the case because, otherwise, these international investors would look elsewhere to invest their surplus capital.

But where else can they go?

The US is, still, one of the best places in the world in which to make money.

Foreign investors are not out to help to finance the US trade deficit, or to do any special favours for the US Government: They just want to make a turn – the bigger the better.

Interestingly enough, because of the attractiveness of investments in the US, the country sees no reason to borrow money, internationally: It is being lent money, obliquely, by foreign investors, who appear to have a great deal of faith in the future of the US and the US economy.

And the high rates of return in investing in the US guarantee that this situation will continue into the foreseeable future.

If some other country(ies) could offer higher rates of return than the US , along with the same degree of security of capital plus profits, international investors would turn their attention, elsewhere.

But they don't turn their attention elsewhere because there is precious little choice in the matter.

A major problem, facing the international investor of any materiality, is that if he were to invest, say in Australia, New Zealand, the Philippines, Japan, etc, even with a higher rate of return than could be obtained by making the same investment in the US, there is a strong probability that, on repatriation of capital and profits, foreign-exchange translation would eat into his investment.

This makes investments in countries, other than the US, less desirable.

A classic example of the above is South Africa.

The exchange rate of the rand was, at one time, $US1.38.

Today, the exchange rate of the rand is about 6.48 cents (US).

Prior to the first, non-racial democratic elections of April 27, 1994, the outgoing South African Government of President F.W. de Klerk was trying to stimulate investments in the country, but all to no avail, even with assurances from the de Klerk Government in respect of guarantees of repatriation of original investments plus profits.

Even double-digit interest rates in the Central Bank of the country failed to attract serious money.

What helps to make the US very attractive is that interest rates in the country are dictated by the prevailing conditions in the US money and capital markets.

This is vastly different to the way that things of this nature are done in many other countries/territories, such as the Hongkong Special Administrative Region of the PRC, the PRC, proper, Japan, the Philippines, just to name a few countries where lenders and/or governmental organisations, directly or indirectly, make determinations as to interest rates, willy-nilly.

As long as the US economy continues to expand, as long as the US dollar continues to be the preferred reserve currency of the world, as long as foreign investors continue to select the US as the place in which to invest, it appears that there is little wrong with the economy of the world's only superpower.

The world is changing and modes of doing business are changing more rapidly than, probably, any other time in the history of the world.

The economic formulae of yesteryear may not be fully applicable in today's world; adjustments will, no doubt, have to be made in order to take into account new emerging trends, trends that cause distortions and/or aberrations to long-in-the-tooth, accepted economic principles.

Creative destruction is taking its toll of the industrialised countries of the world, without question, but as any athlete will attest: No Pain; No Gain.

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