Service With A Smile

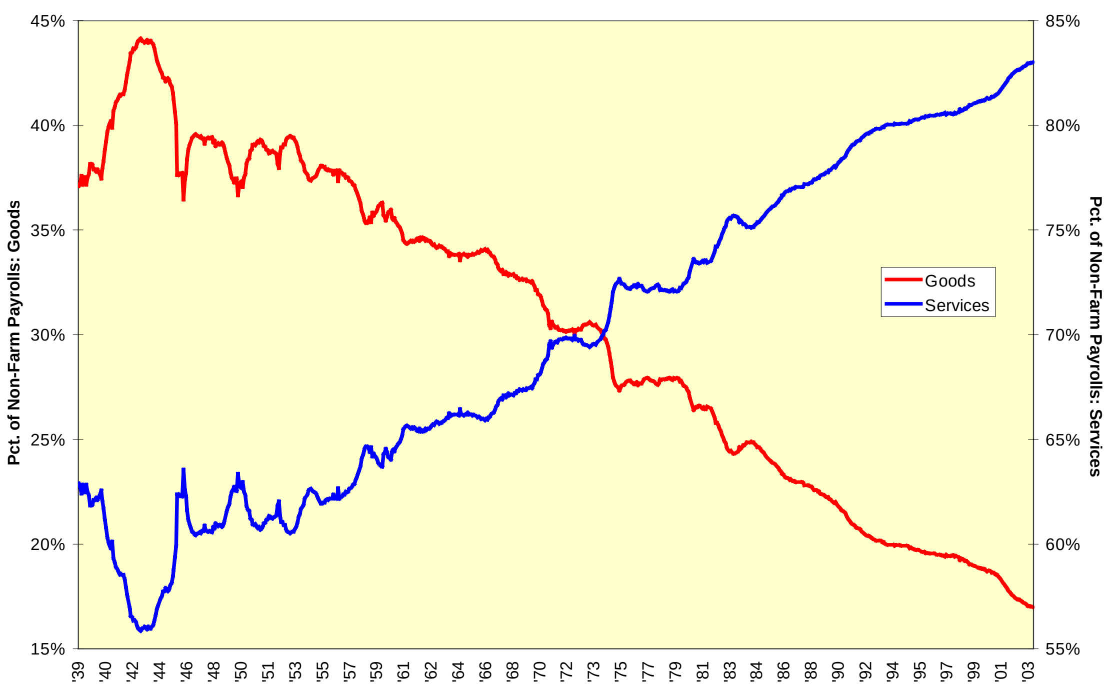
A Columnist Conversation between Paul Kedrosky and myself last week on the outsourcing of technology services triggered a large number of reader e-mails reflective of this new anxiety.

The golden age is never the present one. Societies pine for romanticized and sanitized visions of what they were. Sometimes these shared memories are vital as cultural glue. Most of the time, however, they provide the grist for dangerous reactionaries. Examples include the Luddites and Saboteurs (from the French word "sabot," a wooden shoe useful for throwing into a machine in a fit of Gallic pique) who opposed industrialization in Europe, and the antebellum slaveholders in the United States who somehow found their society morally superior. The *blut-und-boden*, or blood-and-soil, movement preceded the Nazis. Today we must deal with Arab Islamists who long for the Caliphate of Baghdad.

The principle applies for the composition of both the economy and of employment as well. We all started out as hunter-gatherers, which is sort of like a camping trip that never ends. Agriculture soon wedded more than 90% of the population to the land and to the primary task of food production. The remainder of human history is a footnote to the sentence; "People leave the land and do not return." Where did they go? Many became urban industrial laborers, which was idyllic enough to spawn both communism and fascism at the extremes and bad labor-management relations and social welfare states as a matter of course.

The Service Economy
Yet once these jobs, always with the modifier "high-paying" prepended, started their inevitable migration to lower cost zones, often in the Third World, Americans began to fret. The replacement of labor with capital was equally worrisome. These trends have continued since World War II.

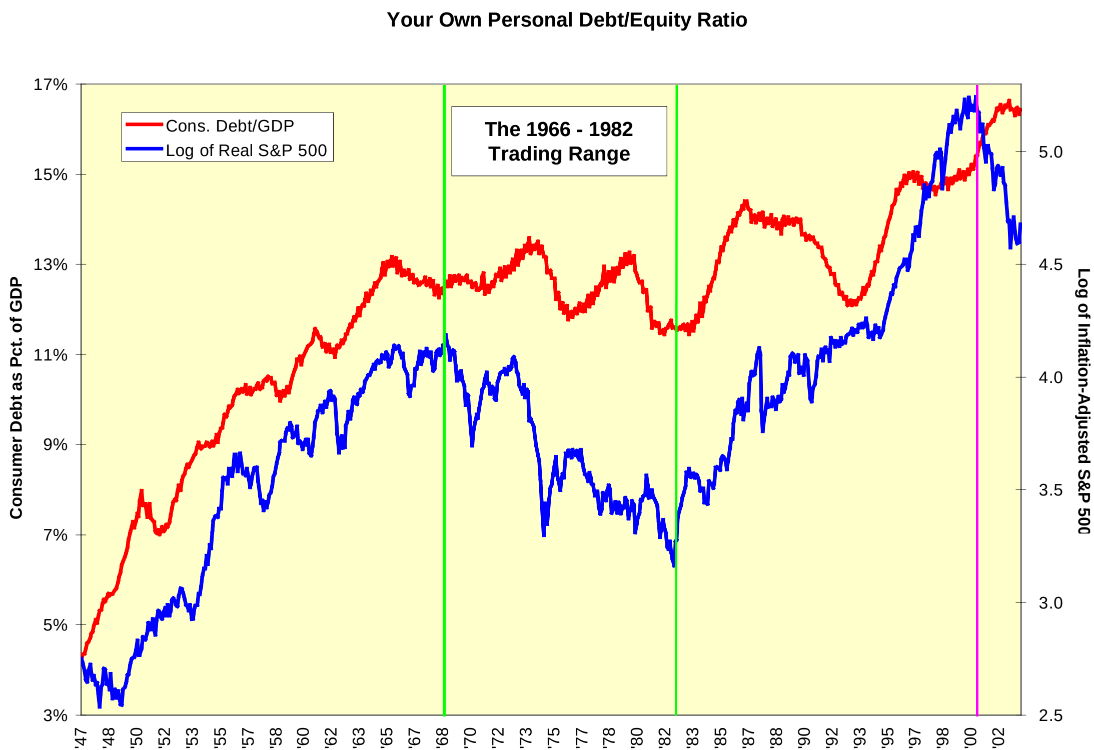
Not A New Trend



To steal a phrase from Ronald Reagan, are we better off now than we were 60 years ago? On both an absolute and a relative basis, the answer has to be "yes," and that answer applies along dimensions other than simple material wealth. But rather than digress into measures such as life expectancy, environmental protection and mobility, let's stick to economic data to demonstrate, with one measure at least, why we should not fear this next great change in the labor market.

Debt And Savings
Societies always have had cultural problems with borrowing and lending. On one level, we extol the virtues of thrift, and on the other we tend to look askance at lending these savings, which are nothing more than foregone consumption, out for interest. But debt provides a key role in the stability and strength of governments, firms and households. No insight contributed to the success of the federal government more than Alexander Hamilton's advocacy of establishing the credit of the new nation through borrowing and subsequent repayment. Firms leverage their equity with borrowing, and how many indicators of a corporation's health are more important than its bond rating?

Individuals save less and borrow more when they feel confident about the future. The ability and willingness of lenders to extend credit to individuals reflects not the dire fiscal straits of borrowers but rather a measure of confidence on both sides that the loan will be repaid. Rising debt levels, if assumed in a strengthening economy and for purposes other than sheer profligacy (pardon my Puritan heritage) are a sign of strength, not of weakness.



Three completed secular, or long-term, markets have characterized the postwar period. These were the 1949-1966 and 1982-2000 bull markets and a massive trading range between 1966 and 1982. This latter period was a trading range in nominal dollar terms only; the inflation of that era made it bearish in real dollar terms. Both of the bullish phases, especially the 1949-1966 one, were accompanies by increases in personal debt relative to GDP. The 1966-1982 range, by marked contrast, witnessed a decline in personal indebtedness.

A continued high level of indebtedness accompanies the present market, which is indicative of both lower interest rates to service the debt and of an overall resilience of the American spirit more than three years after the stock market's peak.

Trade Globally, Inflate Locally
Whether this resilience of both the economy and of our spirits would have existed in either an agrarian or an industrial economy is impossible to determine. All that can be said on these grounds is that any economy linked to primary commodity production is doomed to declining terms of trade over time, and that industrial economies - and these include technology - are linked to investment cycles and therefore have distressing episodes of boom and bust.

To-date, services have been less exposed to global competition than have agriculture and industry. This explains why few industries have pricing power while many services - think of health care, education and government - have strong and even inflationary pricing power. The fiscal and monetary stimulus being thrown at the economy has yet to do much to ignite the industrial sectors, especially those already plagued by overcapacity. These policies may, however, find their way into higher service sector prices. The segments subject to global competition, such as software and data services and telephone service centers, may be rendered less cost-competitive in the global market as a result.

Creative Destruction

The cruelest term in the military lexicon is "friendly fire." Joseph Schumpeter's concept of creative destruction is less deadly in its outcome but affects far more people at any given time. In the short-term, adjustments can be painful. In the long-term, we get a more competitive economy. The key, as always, is to let the market work. There is no chance whatsoever of preventing programming jobs moving to India. The time spent either fighting this or lamenting the development is time wasted.

In 1974, I had to drive through western North Carolina and extreme southwestern Virginia, locale of Hungry Mother State Park. The terrain was beautiful, but the countryside obviously was poor. I took the same trip, this time with my family, in 1996. The former mining and farming towns now had shopping malls replete with video stores, cell phone stores and personal computer stores, three industries that had not existed two decades earlier. I had no way of knowing whether the people felt happier or not, but the scene was brighter.

That anecdote, more than any set of Bureau of Labor Statistics employment data or Institute for Supply Management readings on the industrial and service sectors, is why I remain optimistic over the long term. Today's programmers will develop other skills just as the farmers, laborers and miners of the past had. And we will all be better off for it.