How to Slow the Flow of Hot Money • In Defense of Outsourcing

To make capital controls more effective, the world needs a new set of rules

Until recently, respectable opinion frowned on all barriers to money flowing across borders. Today, the old thinking has been overturned. Sometimes, it's agreed, capital controls are necessary.

The old consensus was wrong and won't be missed. The new view, however, lacks clarity and, when it comes to application, effective oversight. Capital controls may sometimes be necessary-but they're always dangerous and open to abuse. These policies need to be better considered and subject to more careful global supervision.

Since 2008 interest rates in the U.S. have fallen to almost zero, and international investors have looked elsewhere for a good return. Some developing economies have seen enormous capital infusions and a corresponding appreciation of their currencies, which makes their exports less competitive and threatens to cause bubbles in domestic asset prices. Brazil, for instance, responded with a control that once would have been strongly opposed: a tax on foreign investors' holdings of Brazilian assets. Lately the pressure of inflows has abated, and the controls have eased.

A new study by Olivier Jeanne, Arvind Subramanian, and John Williamson of the Peterson Institute for International Economics goes further, arguing that the use of capital controls needn't be confined to incipient asset bubbles. A country with a persistent current-account deficit, such as India, might also find controls useful for avoiding a chronic overvaluation of its currency.

That argument, however, highlights a danger. An instrument that can be used to stop a currency from appreciating too much can also be used to keep it undervalued. China has used capital controls-severe restrictions on the domestic assets foreigners can buy-for exactly this purpose. What China does is equivalent to subsidizing exports and putting tariffs on imports, policies that would be forbidden under the promises it has made as a member of the World Trade Organization.

The current nonsystem on capital controls allows a case like China's to continue indefinitely, where the purpose is not to prevent a currency distortion but to create and perpetuate one, at great cost to others.

Just as global trade rules insist on tariffs, not import quotas, a rule-guided system for capital controls should prefer market-based restrictions, such as taxes, over administrative barriers, such as prohibitions or discriminatory regulation. Market-based measures make it easier for other governments to see what's going on and to judge the effects. In a spirit of cooperation, this is something any government can reasonably ask of another. To curb excesses, the rules on instruments should also specify a maximum rate of tax on capital flows. The academic literature suggests that a moderate rate of, say, 15 percent, is optimal. In addition, governments resorting to capital controls should have to say why-and convince a representative international body with oversight powers.

Now that we better understand the close connections between currency valuations, flows of capital, and flows of goods, we need a global effort to codify and oversee the limited use of capital controls. Do it before bad habits become too hard to break.

Why both candidates miss the mark on outsourcing

The U.S. presidential campaign has gotten sidetracked on a debate over whether Mitt Romney or Barack Obama is the worst offender when it comes to offshoring U.S. jobs. Although the claims on both sides amount to little more than vote pandering, this is still a debate worth having. Among other things, it reveals that the critiques of outsourcing made by Obama and Romney are misguided.

Economists who study global labor trends say companies create jobs outside the U.S. not just because labor costs are much lower, but also to pursue sales opportunities in new markets. They want to be closer to the economies that are growing the fastest and to be able to hire locals who understand the cultural and consumer trends. Even as labor costs become more equal, companies would still hire abroad because that's where the talent pool often is. Companies that don't do this for some patriotic reason would be at a disadvantage to European and Asian competitors, which would probably cause market share to drop and eventually result in U.S. layoffs.

The benefits of moving jobs offshore have been numerous. Outsourcing means less expensive goods and services for U.S. consumers. Workers in China and India, meanwhile, are becoming more like Americans, increasing demand for U.S.-made goods. Outsourcing also allows more advanced industries to replace outdated ones. Eventually, some jobs will flow back to the U.S. because of the combination of rising wages overseas, a stronger Chinese currency, and the availability of low-cost natural gas. Such "inshoring" is already beginning.

This season's electioneering leaves the impression that companies are bad if they outsource jobs, and if they'd only stop being bad, the jobs would come back. Yet many jobs have been lost to automation, not necessarily to offshoring. The presidential campaigns fail to recognize that employment in middle-skill and middle-wage occupations is declining rapidly. If the candidates wanted to be constructive, they would tell voters the hard truth-that most of the mid-level jobs are never coming back. They should talk about their plans to improve math and science education, and how to retrain workers to perform more high-skilled tasks. That's the conversation both candidates are avoiding, but shouldn't. **O**

• *To read Stephen L. Carter on Lincoln and Jonathan Alter on voter suppression in Pennsylvania, go to: Bloomberg.com/view*

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