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Offshoring and Public Fear: Assessing the Real Threat to Jobs

By Ted Balaker and Adrian T. Moore, Ph.D

POLICY STUDY 333

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Executive Summary

During the 2004 presidential campaign, pollsters found widespread public support for measures designed to impede outsourcing. State and federal lawmakers paid attention, and quickly penned over 200 anti-outsourcing proposals. Now that election year has passed, one might have expected anti-outsourcing momentum to slow. Yet the opposite has happened—legislators are now crafting anti-outsourcing bills at an even faster pace.

Policymakers must step back and separate the outsourcing's mythology from its reality. Contrary to hyperbolic stump speeches, workers have little to fear from outsourcing. Greater threats may come from shortsighted attempts to stymie outsourcing, and from allowing outsourcing to distract lawmakers from addressing lingering problems.

Outsourcing is not a newly created threat to jobs. It is merely a version of trade, and like previous versions of trade it brings some pain—but it brings even more promise.

The public debate about offshore outsourcing suffers from many misconceptions:

Misconception	Reality
Everyone is offshoring	Few companies offshore.
Foreign workers are taking American jobs.	Most American jobs are lost to other Americans or absorbed by new technology.
Outsourcing destroys jobs.	Job loss from outsourcing has been grossly overstated.
The American worker has nothing to gain from outsourcing.	Outsourcing is a form of trade, and trade creates more jobs than it destroys.

Misconception	Reality
Outsourcing destroys high-end jobs.	Few high-end jobs are at risk, and outsourcing will help create more high-paying jobs than it destroys.
Outsourcing is a one-way street.	Millions of Americans have jobs thanks to "insourcing."
Companies could simply refuse to go offshore.	Refusing to offshore can mean foregoing expansion or worse.
Outsourcing is driven by businesses looking for cheap labor.	Where a company decides to do business is determined by many factors.
Government sector offshore outsourcing is widespread.	Government sector offshore outsourcing is especially rare.
Only Republicans defend offshore outsourcing.	Many well respected voices across the political spectrum have defended offshore outsourcing.

Fight the Real Threat of Outforcing

Some jobs leave town because the natural evolution of the market allows them to be done somewhere else; others get chased out by costly policy decisions, that is, they are out*forced.*

In the United States, federal, state and local tax policies, convoluted labor laws and policies, outdated licensing and permitting requirements, unduly burdensome land use and environmental regulations and many other layers of the regulatory apparatus have driven up the costs of doing business and thus creating jobs, making other nations more competitive at producing some goods and services. Increasingly this suite of policies raises costs to the point of *outforcing* jobs to other nations.

And like outsourcing, outforcing is mostly a domestic phenomenon. Some jobs get forced overseas, but even more get pushed from city to city and from state to state.

Outsourcing absorbs much negative publicity, but actually does more good than harm. Outforcing, on the other hand, is not the source of national outrage even though it makes more mischief. Policy should not fight outsourcing, it should fight the real threat—outforcing.

Part 1

Introduction

A. Outsourcing is Not New

Has offshore outsourcing come out of nowhere? Suddenly news reports ask, "Will your job go overseas?" The American worker considers the question and trembles. Often, as evidenced by the billboard in the picture below, anxiety turns to calls for political action.

Indeed, during the 2004 presidential campaign, pollsters found widespread public support for measures designed to impede outsourcing.[1] State and federal lawmakers paid attention, and quickly penned over 200 anti-outsourcing proposals. Now that the election year has passed, one might have expected anti-outsourcing momentum to slow. Yet the opposite has happened—legislators are now crafting anti-outsourcing bills at an even faster pace.[2]

What is Outsourcing?

Outsourcing can occur in the private sector, such as when an insurance company hires another company to book business travel for its employees. Outsourcing can also occur in the government sector, such as when a city contracts with a private company to collect garbage. Whether in the private or government sector, outsourcing is simply a management tool that allows an organization to devote more time and resources to its core mission, for example, selling insurance or ensuring the efficient provision of quality government services.

Note how the preceding discussion is distinct from *offshore* outsourcing, the topic that has generated so much controversy lately. As this study reports, there is no universally accepted definition of "offshore outsourcing." Generally speaking, the term refers to U.S. organizations that contract with foreign entities to provide services. Again, this process occurs in both the private and government sectors. Most media coverage has focused on the private-sector variety, but government-sector offshore outsourcing has garnered an increasing amount of attention. Also, in the public debate, the adjective "offshore" is typically dropped, which often invites confusion, as it becomes difficult to distinguish between "offshore" and "domestic" outsourcing.

The lack of a universally accepted definition makes gleaning information from statistics a bit more complicated, as one study may adopt a slightly different definition from another. Researchers have also only recently begun to investigate the specific facets of this topic. When it comes to outsourcing, available information doesn't yet give us a perfectly clear picture. Yet the picture, even with its blurry edges, is still a useful one.

Policymakers must step back and separate outsourcing's mythology from its reality. Contrary to hyperbolic stump speeches, workers have little to fear from outsourcing. Greater threats may come from shortsighted attempts to stymie outsourcing, and from allowing outsourcing to distract lawmakers from addressing lingering problems.

Outsourcing is not new; it's merely the latest evolution of a friendlier concept—trade. Trade is an old tree, and outsourcing is simply the latest branch to sprout out of it. Trade allowed our ancestors to spend less time simply struggling to stay alive and more time creating more comfortable, more fulfilling lives. We have traded with foreign nations for centuries, and the rise of outsourcing merely brings increased trade in *services* (such as customer service calls) as well as *goods* (such as cars).[3]

B. Trade and Technology: Improving Society by Improving Efficiency

Throughout most of our existence, we humans have struggled simply to stay alive. Scraping together enough food was a never-ending chore, as was surviving the elements and avoiding disease.

Eventually our ancestors learned how to improve their lives with trade. They joined with others and divided labor. One person might focus on farming, another on raising livestock. By focusing on a specific task each developed expertise that would not be possible if he had spread his efforts across many different pursuits. Neighbors traded corn for meat, and each was better off than if he had tried to tackle both duties himself.

Trade grew. Trade within villages expanded to inter-village trade, and trade among villages eventually expanded to international trade. As people spent less time simply trying to stay alive, they spent more time improving their lives. They created inventions, such as boats that could travel great distances, which allowed trade to expand even more.

Like trade, technology improves society by improving efficiency. Trade and technology can shake the economy in similar ways, and they are often reinforcing. Trade spurs technology and improved technology allows for more trade.

Agricultural innovations, from irrigation to fertilizers to pesticides, have allowed farmers to do more with less. Today farmers can produce larger yields on smaller plots of land, and their crops are also less vulnerable to the whims of Mother Nature.

Efficient Agriculture

It is because we use farmland so effectively now that President Clinton was recently able to set aside another 50 or 60 million acres of land as wilderness areas. That would not have been possible had it not been for the efficiency of modern agriculture.

In 1960, the production of the 17 most important food, feed, and fiber crops--virtually all of the important crops grown in the U.S. at that time and still grown today--was 252 million tons. By 1990, it had more than doubled, to 596 million tons, and was produced on 25 million fewer acres than were cultivated in 1960. If we had tried to produce the harvest of 1990 with the technology of 1960, we would have had to have increased the cultivated area by another 177 million hectares, about 460 million more acres of land of the same quality…

Source: Nobel Laureate and Father of the "Green" Revolution, Norman Borlaug, "Billions Served," *Reason*, April 2004: http://www.reason.com/0004/fe.rb.billions.shtml

In more recent years, the telecom and Internet boom produced many efficiency-improving innovations that make it increasingly easy to share information. Today we can transmit data across town or across the world instantly and at almost no cost (See Table 1). The emergence of new technology provided the foundation for increased trade in services and the emergence of the knowledge-based economy. Just as workers welcomed the opportunity to trade fields for factories, they have gladly moved from factories to offices.

Table 1: Sending a Page of Text: How long does it take and how much does it cost?

	Delay for 1 Destination	Delay for 100 Destinations	Cost for 1 Destination	Cost for 100 Destinations
Pre-Railroad Mail (1840s)	252 hrs	260.3 hrs	$0.25	$107.17
Railroad (1850s)	48 hrs	56.3 hrs	$0.03	$85.17
Telegraph (1850s)	0.083 hrs	8.3 hrs	$7.50	$750.00
Email (2000s)	~0	~0	~0	~0

Source: Thomas W. Malone, *The Future of Work* (Boston: Harvard Business School Press, 2004).

As societies began to appreciate and embrace economic freedom, life expectancy, which had remained flat for so long, began to grow rather quickly. From 1750 to today, life expectancy increased from about 30 years to 76. Sadly, life expectancy continues to stall in poor nations where leaders eschew trade and other elements of economic freedom. Those who live in the wealthiest nations can expect to live 22 years longer than those who live in the poorest. And economic freedom is not only associated with longer life spans but with higher quality of life, as well (See Box).

Economic Freedom and Quality of Life (Figures 1-4)

Figure 1: Economic Freedom and Life Expectancy (2002)

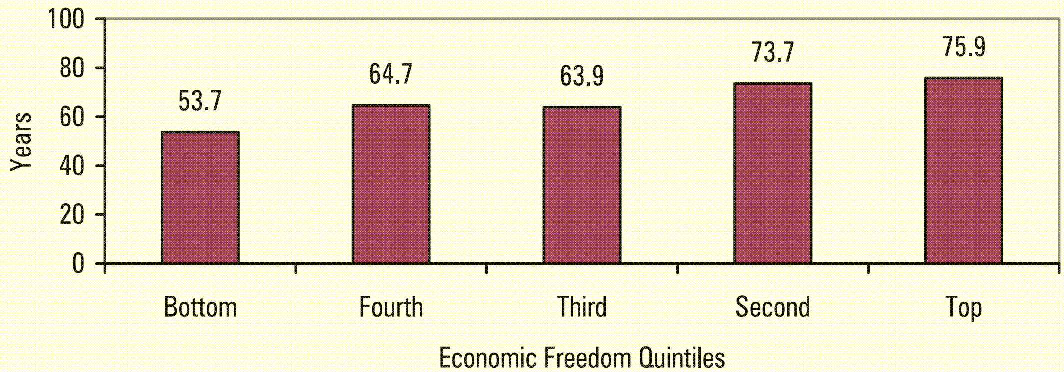


Figure 2: Economic Freedom and Per-Capita Income (2002)

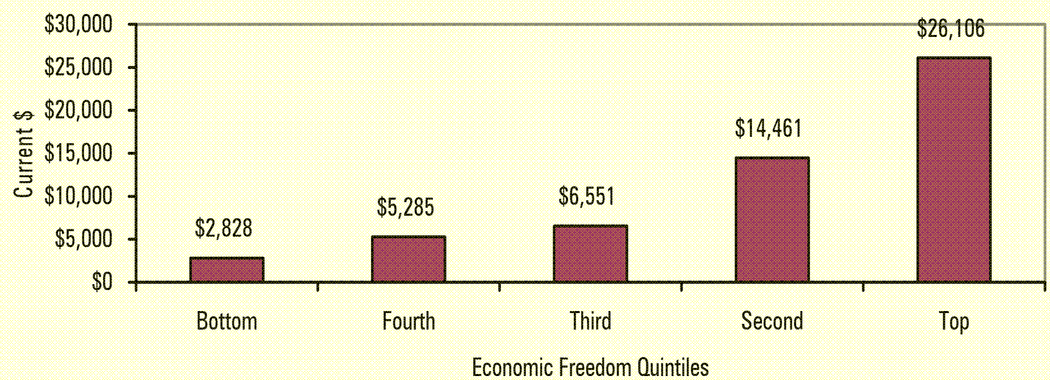
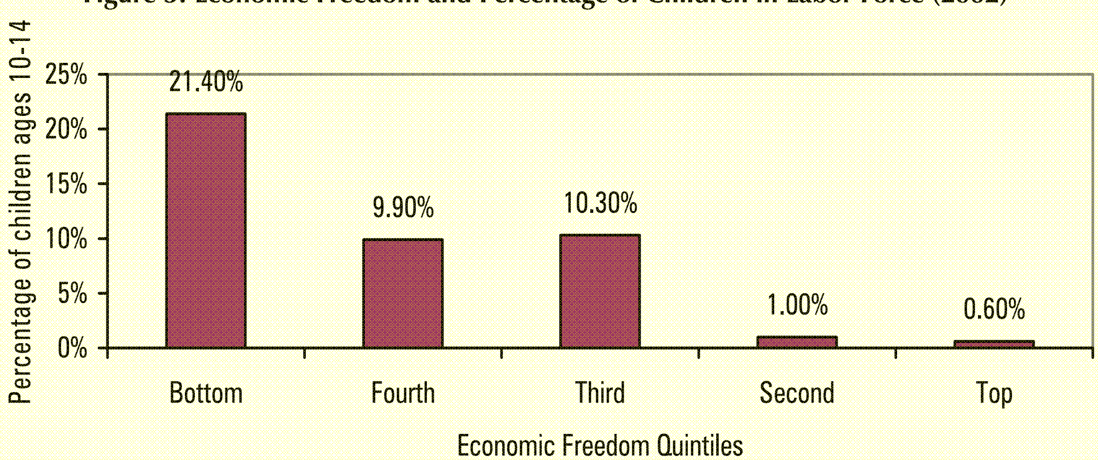
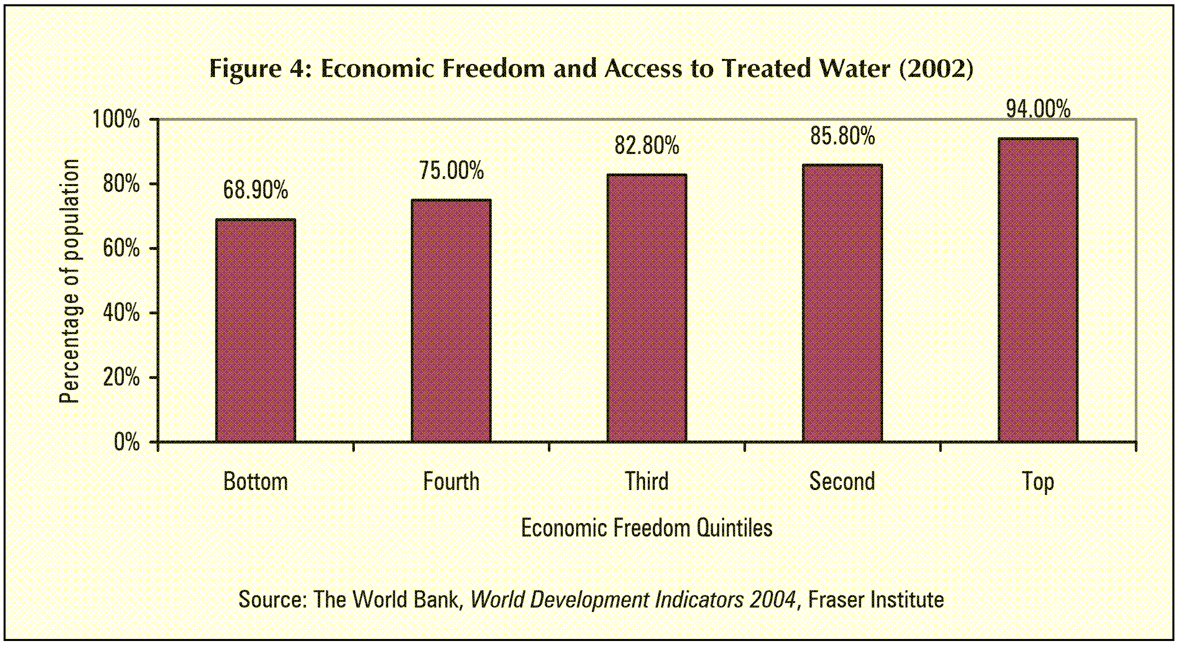


Figure 3: Economic Freedom and Percentage of Children in Labor Force (2002)





C. Today's Job Threat, Tomorrow's Job Creator

Of course, innovations that lead to greater efficiency are often only appreciated in hindsight. Today we herald the movable-type printing press as one of civilization's most important inventions, and yet it stirred anxiety in 15th century society:

> *Copyists protested that printing would destroy their means of livelihood; aristocrats opposed it as a mechanical vulgarization, and feared that it would lower the value of their manuscript libraries; statesmen and clergy distrusted it as a possible vehicle of subversive ideas …*[4]

Nineteenth century weavers responded to the emergence of mechanical looms with riots, and even trains, which seem so unthreatening today, brought great worry as well as great opportunity. The railroad spurred interstate trade, and local merchants had no choice but to compete with the rest of the nation. Imagine how frightening this new threat must have been.

More recently, computers threatened the jobs of office workers, and Japanese competition threatened American auto workers. Free trade agreements like NAFTA and GATT exposed Americans to greater competition from abroad, and the Internet threatened to disregard any borders that remained.

Naturally, any change to society stirs fear, as some segment of society exchanges a comfortable status quo for an unknowable future. Economists often use the term "creative destruction" to describe the market's evolution: some portion is destroyed, but more is created. Indeed, each efficiency gain—whether prompted by expanded trade or improved technology—provoked protest, but each created more than it destroyed. Like its predecessors, outsourcing causes pain, but ultimately, it too will create more than it destroys. The economy that is best for workers is not the one that fears change, but one that is dynamic and resilient, one that absorbs new innovations and transforms them into more and better jobs.

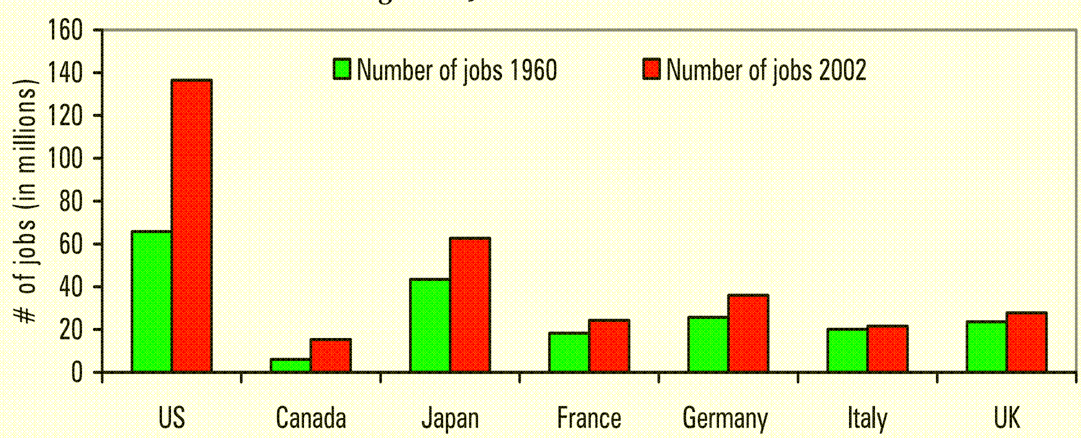
Evolving Fears

How odd to see angst about corporate America shift from concern 100 years ago about monopoly to today's concerns about offshoring and globalization. Today local connections, nimbleness, and specialization are becoming more important in the world and in the domestic economy. International trade in services via offshore outsourcing allows everyone to benefit from this evolution and it is a key driver in creating higher productivity and living standards in nations that participate in free and open markets. Today's most fertile ground for fast-growing companies are smaller, technologically evolved organizations that leverage global communications and labor resources to successfully win business based on local conditions. This occurs most often where there are few barriers to entry for new firms and few limits on firms' access to global labor and product markets.

1. Innovation Has Much to Offer the Worker

Compared to the United States other western democracies tend to have more regulated economies and more rigid labor laws. Such laws, as well as generous social welfare benefits, give workers greater protections against layoffs. They are designed to shield workers from the seemingly callous churn of the market. But since these nations are less willing to accept job losses, they are less able to enjoy job gains. Business owners are hesitant to expand hiring because they know that they will have a hard time shedding jobs during economic downturns. The more burden and expense that is associated with hiring, the more businesses will try to make do without hiring more employees. The result is that fewer jobs are created. Figure 5 shows how job creation in the United States has dwarfed other modern economies.

Figure 5: Job Growth 1960-2002



Source: U.S. Department of Commerce, Bureau of Labor Statistics and Public Policy Institute of California

Even though an innovation-based economy values efficiency first, it is still the most compassionate system for the worker. An innovative economy does more than create many jobs, it also keeps unemployment relatively low. In 1960 56 percent of America's adult population was employed, by 2002 that figure had grown to 63 percent. European unemployment rates typically stand much higher than America's rate. For example, during the 1990s unemployment in France and Italy was roughly twice that of the United States. Spain's unemployment rate was roughly three times as high.[5]

And, in an innovative economy, unemployment will be comparatively brief. The efficiency-seeking forces that fire a worker are the same ones that will rehire him. In the United States, most unemployed workers find new jobs in about three months, while an unemployed European can expect to remain jobless for nine months. In certain European nations the long-term unemployment rate (over 12 months) accounts for nearly a third of unemployment.[6]

News accounts typically focus on how the outsourced worker will get along without a salary, but the cost of products also has a big impact on living standards. When measured as the amount of time a person must work to make enough money to buy something, the price of just about everything has fallen dramatically (see Table 2).

In 1901 Americans spent 43 cents of each consumer dollar on food. The figure fell to 32 cents in 1950 and only 13 cents in 2003.[7] More buying power helps the outsourced worker weather the lean times of unemployment, and it is the emphasis on efficiency that allows us to fill our bellies and meet other basic needs with more ease than at any other time in history.

Table 2: How long must someone work to purchase various goods?

Product	1920 worker	1997 worker
Chicken	2 hours	15 min.
Candy bar	20 min	2 min.
Soft drink	20 min	2 min.
Dozen eggs	20 min	5 min
Car	4,696 hours (Model T)	1,363 hours (Taurus)

Source: Michael Cox and Richard Alm, Myths of Rich and Poor, (New York: Basic Books, 1999).

Today, housing is the largest expense for the average American family (accounting for 33 cents of every dollar spent), followed by car expenses (19 cents), food (13 cents), and medical bills (6 cents).[8] A good indicator of whether a certain good drops in price is the extent to which it is exposed to trade and competition. For example, while food prices in general have fallen dramatically, less-traded products like sugar and peanut butter have increased in cost in recent years.[9]

What about housing? The ranks of homeowners have grown, and today 69 percent of families own homes. Those homes are also growing in size. In 1950 the average new home was below 1000 square feet; today the average new home has swelled to 2,300 square feet.[10] Yet public policy—from tight land use policies to rent control—often restricts trade and makes the cost of housing unnecessarily high.

Health care is another sector in which prices have risen partly because of policies that restrict trade and competition. Another important factor is simply quality. Modern medicine has improved dramatically and often patients pay more to receive better treatments—treatments that were not available to recent generations. Organ transplants, rare and risky just a few decades ago, are now commonplace. In recent decades, many other medical advances, from CAT scans to ultrasound, have emerged.

And yet a better product can come with a lower price. Perhaps most astounding is the pace at which computer technology is improving in quality even as it declines in price:

> *The IBM-370-168 mainframe circa 1975 sold for $3.4 million; a personal computer today with an Intel Pentium chip currently retails for around $1,000 and is at least 100 times faster.*[11]

As amazing as that anecdote is, it is quite outdated even though the book that references it was published fairly recently (2000). Today's consumer can buy a computer that is hundreds of times faster and half the cost of the models that were available just five years ago. Here international trade has played a key role in dropping prices and improving quality.[12]

The tools of self-expression and self-improvement, once available only to society's wealthiest, have been democratized at a rate unseen in human history. Today one need not be a member of the privileged class to create music, cut a film or design a Web site.[13] Likewise, falling prices have broken down barriers to entrepreneurship. Americans have grown familiar with the motif of college kids, perhaps even college dropouts, using inexpensive technology to compete with, and even topple, corporate giants.

2. What about the poor?

An innovative economy will have upheavals and job displacements, and it is true that the poor are most vulnerable. Yet the poor are most vulnerable in any system, and it is better to be poor in a rich nation than in a poor one. There are even rather stark differences among relatively wealthy nations, as a Swedish report points out:

> *Poverty is a relative concept … 40 percent of all Swedish households would rank among low-income households in the USA, and an even greater number of the poorer European countries would be classified as low income earners by the American definition. In an affluent economy, in other words, it is not unlikely that those perceived as poor in an international perspective are relatively well off.*[14]

Based on many indicators of material well-being, America's poor compare favorably to the middle class in other nations. Most poor households in the United States have at least one car, air conditioning, a refrigerator, cable television, and a VCR or DVD. Poor Americans also enjoy more dwelling space (square feet) that the European average.[15]

Perhaps most importantly, an innovation-based economy offers the poor the best shot at upward mobility. In America, even those on the bottom rarely stay there for long. Each year 20 percent of those in this group move up at least one income quintile.[16] Give the process more time and the vast majority of the poor move into middle-class standing or higher. Table 3 shows the progress various ethnic groups have made.

Table 3: Poverty Percentages by Ethnic Groups

	1959	1999
Whites	18	10
Blacks	55	24
Hispanics*	23 (1972)	23
Total	22	12

* Immigration trends may obscure progress made by Hispanics. Individuals may escape poverty but new arrivals tend to be poor and add to the ranks of poor Hispanics.

Source: Theodore Caplow, Louis Hicks, and Ben Watttenberg, *The First Measured Century: An Illustrated Guide to Trends in America* (Washington, D.C.: American Enterprise Institute, 2001).

3. Is it the responsibility of business to create jobs?

Innovations stir so much fear largely because we can see how they make some jobs obsolete. Since we often assume that the purpose of business is to provide jobs, we may react with outrage. But this reaction misunderstands why jobs are created in the first place.

Economist Israel Kirzner has long studied the essence of entrepreneurial activity. He notes that the entrepreneur is inspired not by the prospect of creating jobs but "by the prospective pure-profitability of seeing the future more correctly than others do."

To Kirzner "alertness" to opportunity is the central component:

> *Entrepreneurial discovery represents the alert becoming aware of what has been overlooked. Then essence of entrepreneurship consists in seeing through the fog created by the uncertainty of the future.*[17]

Entrepreneurs tend not to be motivated by a desire to create jobs; they aim to make money, to express themselves creatively, and to achieve personal fulfillment. They may seek a combination of these and other goals that go beyond self-interest. Altruism often plays a role, but it is typically an altruism that focuses on the result of the vision, not the process. An inventor might manufacture a better wheelchair because he or she wants to help the handicapped improve their lives. Yet, even in this scenario, creating jobs is not at the motivational core of economic activity.

Once the entrepreneur settles on his or her personal goals, the question becomes: How shall I achieve these goals? Even at this stage, the answer is not "by creating jobs." In order to gain wealth, fulfillment, or any other goal, the entrepreneur must first please the customer by, for example, offering lower prices for some good or service, by offering more variety, by improving something, or by creating something new.

Whether the issue is outsourcing, the Internet, international trade, or any other efficiency-seeking innovation, the same criticism emerges: the process puts profits before people. However, the fixation on process often obscures the results of that process. Though the process of trade does not seek to create jobs, job creation is a welcomed side effect.

As trade expands, specialization expands, and efficiency improves. Greater efficiency saves money and allows companies to do more of what they were already doing or expand into related fields. In each case companies are likely to need more employees. Greater efficiency also helps lower prices for consumers, and, as it becomes cheaper to meet their basic needs, consumers are willing to spend more on new wants and needs. Entrepreneurs step in to cater to this new demand, hiring employees in the process.

Today's job threat is often tomorrow's job creator, and yet society often persists in meeting innovation, not with hopeful expectation, but with fear. Sadly, instead of putting offshore outsourcing into perspective many lawmakers, pundits, and journalists have played to public fears. They have allowed outsourcing's legend to outgrow its reality.

Part 2

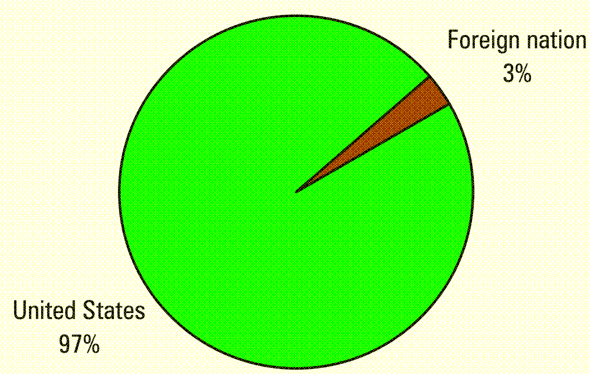
Misconceptions

The mountain of misleading information that has hardened into conventional wisdom makes it difficult to discuss outsourcing. It is first necessary to address some common misconceptions.

1. Misconception: Everyone is offshoring.
Reality: Few companies offshore.

There is reason to believe that politicians and reporters have overstated outsourcing's revolutionary nature. In recent decades corporations have made increasing use of outsourcing by hiring other companies to do specialized work and tasks not central to the outsourcing company's mission. Yet the vast majority of outsourcing business stays within the United States. Ninety-seven percent of the services consumed by Americans are provided by Americans.[18] And, even though reporters and politicians lavish it with attention, offshore outsourcing probably accounts for only a fraction of 1 percent of U.S. GDP.[19]

Figure 6: Where the Services Americans Consume are Produced

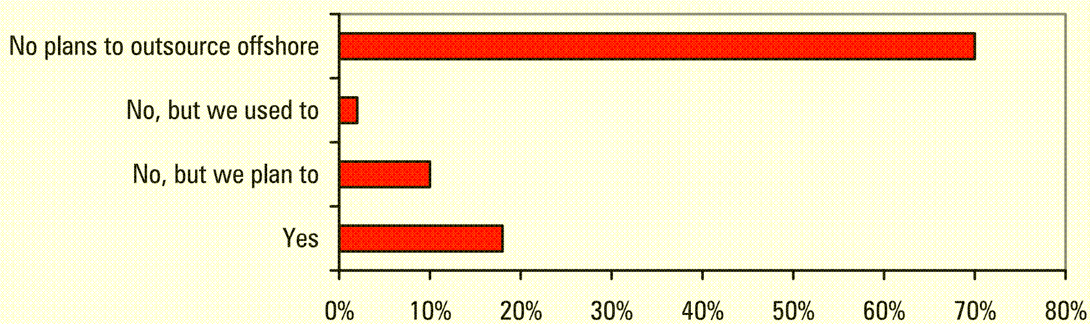


Source: GAO

The very largest companies are quite likely to make at least some use of offshoring. For example, one survey of 80 executives from mostly Fortune 500 companies found that half of their companies outsource offshore.[20] Yet a very small percentage of Americans are employed by Fortune 500 companies. Take a small step down in size and one finds that most companies, even large multinationals, have not embraced outsourcing.

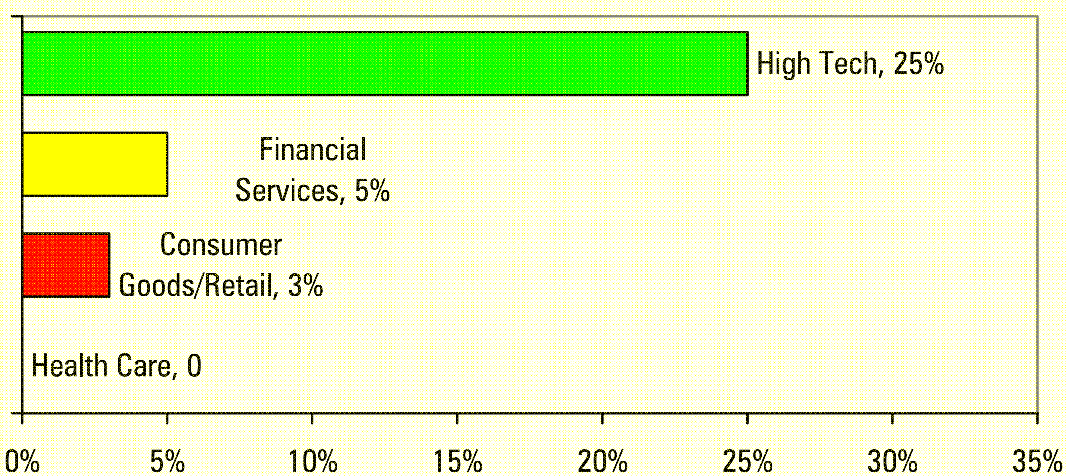
- One survey of 275 companies revealed that only 18 percent currently use offshore outsourcing (Figure 7).[21]
- Another survey of over 300 companies found similar results. High-tech companies are probably the most likely to turn to outsourcing, yet only 25 percent of those surveyed use offshore outsourcing. Other kinds of companies use offshore outsourcing even less often (Figure 8).[22]
- Yet another survey of over 700 organizations found that only one-third of respondents outsource, and of those, 70.2 percent outsource domestically. Only 21.5 percent say they have gone offshore, and another 2.8 percent have outsourced "near-shore" (e.g. Canada or Mexico).[23]

Figure 7: Outsourcing: Not So Widespread After All
Does your company currently use offshore outsourcing?



Source: Kate O'Sullivan and Don Durfee, "Offshoring by the Numbers," *CFO Magazine*, June 1, 2004.

Figure 8: Percentage of Companies Currently Using Offshore Outsourcing



Source: "CEO Survey: Outsourcing: The Path to Achieving Business Transformation Goals," *Chief Executive Magazine*, June 2004

It is likely that outsourcing will become more prevalent in the future, but how much outsourcing grows, and how much it reshapes the American workforce is another matter entirely. Companies are learning that outsourcing is not a painless and failsafe path to greater profits.

In the early 90s, Kolawa, a struggling software provider, was one of early entrants into offshore outsourcing. The firm could not resist the cheap labor available in post-communist Poland. Unfortunately, endemic political corruption and cultural barriers between the firm and its Polish developers added new costs.[24]

Kolawa stuck with the arrangement and eventually improvement followed, but recently some firms have found outsourcing to be more trouble than it's worth.

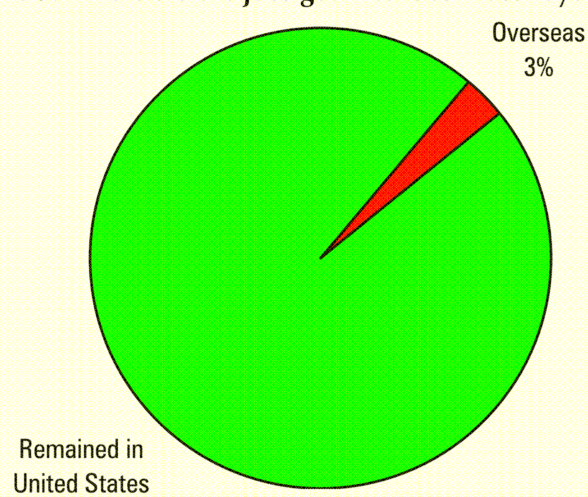
- After customers complained about having trouble understanding thick accents, Dell brought tech-support jobs back to the United States.
- Lehman Brothers brought a 20-person help desk back to the States, citing the need for on-site responses.
- Capital One backed out of a contract with an Indian call center after discovering workers were promising unauthorized lines of credit to entice potential customers.[25]

Still, each firm plans to keep other operations overseas, and that approach will likely reflect outsourcing's future. Outsourcing will suit certain firms in certain situations. It will neither save the world nor destroy it. Done right, it will improve economic efficiency and contribute to improved living standards here and abroad.

2. Misconception: Foreign workers are taking American jobs. Reality: Most American jobs are lost to other Americans or absorbed by new technology.

While the federal government has only recently begun to track offshore outsourcing, the figures that are available suggest that most outsourced jobs never leave American soil. The Bureau of Labor Statistics notes that in 2004 only between 1.7 and 3 percent of mass layoffs involved overseas location.[26]

Figure 9: Where did the jobs go? Extended Mass Layoffs 2004



Source: Bureau of Labor Statistics

The report suggests that fears over losing American jobs to cheap foreign competition are overblown. In most cases, outsourcing had nothing to do with mass layoffs, and when jobs were lost from relocation, 69 percent stayed within the United States.[27]

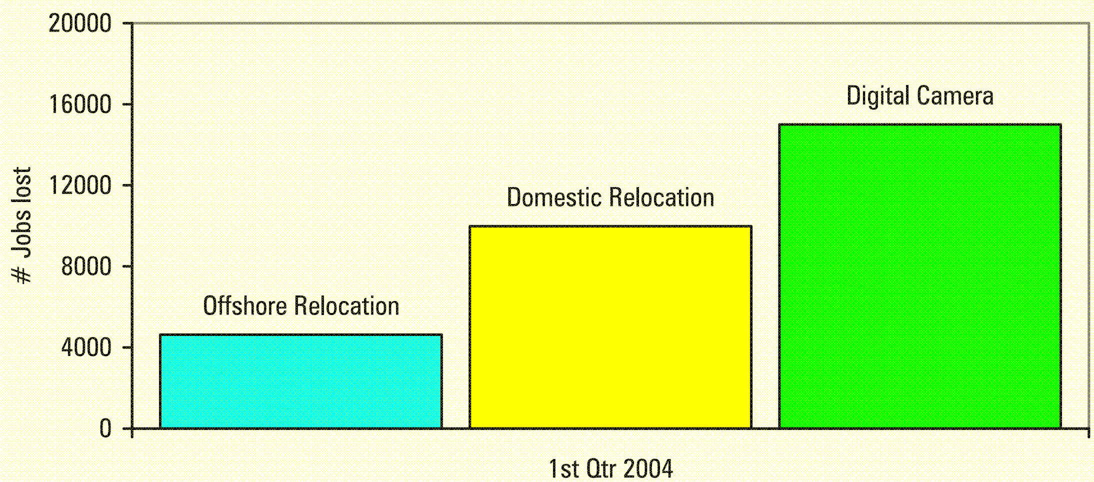
Take a longer view and job loss from overseas location continues to represent a tiny portion of total job loss. Of all the mass-layoff job losses reported between 1996 and 2003, overseas relocation accounted for only 0.9 percent. Note that this period contains data for 2002, the peak year for overseas relocation.[28]

In other words, Americans are taking American jobs. To some, domestic outsourcing may be more palatable than offshore outsourcing, but to an outsourced worker, whether his job goes across the nation or across the world, it is just as lost.

An analysis of Bureau of Labor Statistics data suggests that, even without outsourcing—technology would have eliminated most of the jobs now going overseas.[29] A Columbia University study agrees that technological change will likely cost more jobs than outsourcing.[30] The research firm Gartner expects that by 2015 automation will displace six times as many IT jobs as offshoring.[31]

Evidence suggests that even the seemingly innocuous digital camera shakes the job market more than offshore outsourcing. During the first quarter of 2004 Kodak announced layoffs of 15,000 workers because the growing popularity of digital photography decreased the need for film processors. [32] Kodak's single announcement accounted for more than three times as many jobs lost to offshore outsourcing during that same quarter.[33]

Figure 10: What Causes Job Loss?



Source: Bureau of Labor Statistics

Perhaps the most compelling evidence that technology displaces more workers than offshore outsourcing is that output increases even as employment decreases. Consider manufacturing.

From 1995 to 2002, worldwide manufacturing employment fell 11 percent. Yet during that same period, manufacturing output rose by 30 percent. In the United States the drop in manufacturing employment mirrored the worldwide drop (11 percent). If trade with poor nations had caused the job loss, then we would expect low-wage nations to gain manufacturing jobs. Yet, as Table 4 reveals, low-wage nations have shed an even greater percentage of manufacturing jobs.

Table 4: Manufacturing Job Loss (1995-2002)	
Nation	**Percent Change**
Brazil	-20
China	-15
Russia	-12
United States	-11

Source: Haver Analytics, AllianceBernstein

Sometimes it seems like our society is so mechanized that there is almost nothing left for us humans to do. The printing press swallowed human scriveners and the photocopier and personal computer destroyed countless office jobs. Louisville mourned when a machine replaced the city's last human elevator operator, and even the recently resolved Southern California grocery strike may turn out to be another victory for machines. Here man and machine used to work together in peace—for example, human checkers appreciated how scanners would remember thousands of prices for them. But now some stores have begun phasing in automated checkout machines, which means human checkers work along side machines that may eventually take their jobs.

Even call center jobs, so closely associated with outsourcing, are beginning to be replaced by automated technology. For example voice recognition technology allows consumers to find answers to all sorts of questions—from flight status to credit card charges—simply by speaking to a computer.

3. Misconception: Outsourcing destroys jobs.
Reality: Job loss from outsourcing has been grossly overstated.

As of 2003 roughly 400,000 American jobs had been outsourced to overseas providers.[34] While this figure may seem large, it represents less than 1 percent of the civilian workforce.

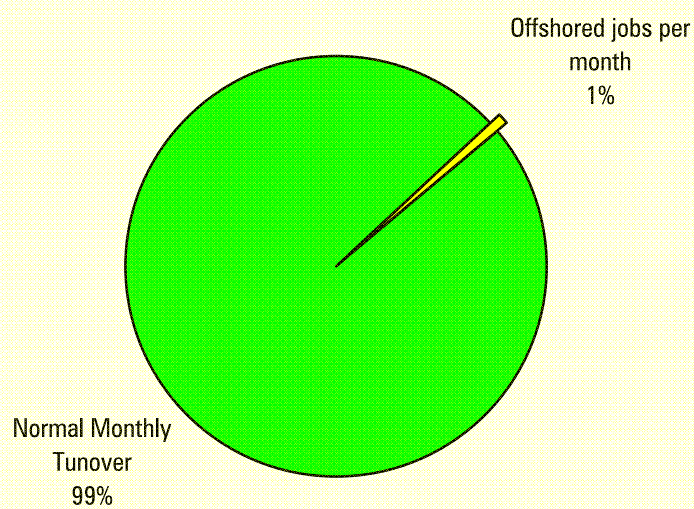
Since this figure only accounts for layoffs borne by companies with 50 or more employees, it likely understates the number of offshored jobs. But even if the actual figure is somewhat higher, a less threatening picture still emerges: Offshoring affects only a fraction of America's workforce.

Some concede that, thus far, job loss from outsourcing has been overstated, yet they fear what the future might bring. Forrester Research produced perhaps the most cited estimate of offshoring's projected growth, claiming that 3.4 million jobs could go overseas by 2015.[35]

While 3.4 million seems like an enormous figure, it represents only a tiny fraction of today's labor market, and an even tinier fraction of the labor force in 15 years. Further, the 3.4 million jobs would not be lost all at once, but would be spread across many years. So even if we accept this high-end estimate, it would mean that each year outsourcing would affect less than 0.2 percent of American workers.[36]

Outsourcing's impact seems particularly slight when compared against normal economic conditions. The American economy is in constant motion—workers leave jobs and find new ones all the time. In fact, in a typical month 4 million Americans will either quit their jobs or get fired.[37] Figure 11 compares normal monthly job turnover for a single month to the job loss projected by Forrester.

Figure 11: Outsourcing's Potenital Impact: Putting It Into Perspective



Source: Bureau of Labor Statistics, Forrester Research

The vast majority of jobs are simply ill-suited for offshoring, as University of Chicago political scientist Daniel Drezner observes:

> *[C]lose to 90 percent of jobs in the United States require geographic proximity. Such jobs include everything from retail and restaurants to marketing and personal care -- services that have to be produced and consumed locally, so outsourcing them overseas is not an option.*[38]

Another estimate suggests that only 4.2 percent of the American labor force works in occupations at risk for outsourcing. And, as of 2003, over 97 percent of workers in these most at-risk occupations were untouched by outsourcing.[39]

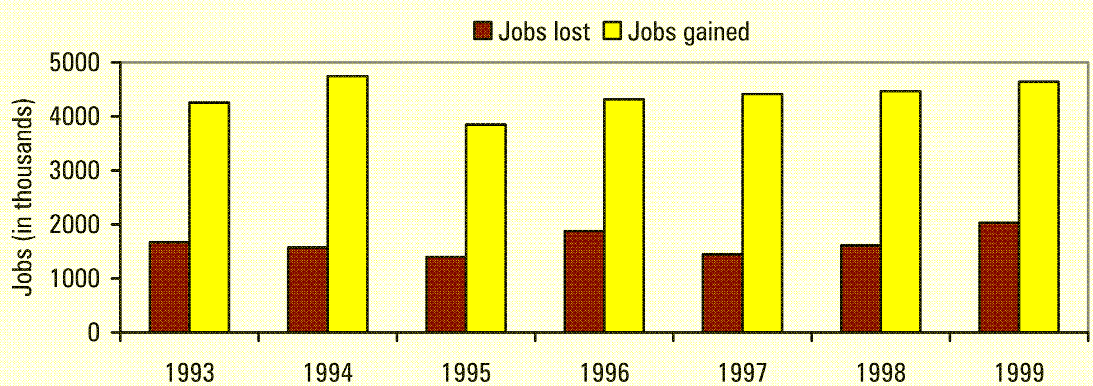
We cannot predict how outsourcing will evolve in the future, but thus far fears about its impact have dwarfed what it has really done.[40]

4. Misconception: The American worker has nothing to gain from outsourcing. Reality: Outsourcing is a form of trade, and trade creates more jobs than it destroys.

Pundits and politicians often take a narrow time frame or a specific occupation and tell a tale of woe. Sometimes an industry disappears or shrinks to a nub of its former self, and yet new life continues to sprout. Many occupations that were once popular now comprise only a tiny percentage of our workforce, and yet the number and variety of jobs continues to expand.

The public debate about the state of the economy typically fixates on a narrow time frame, and usually this is driven by election year politics. Often the debate settles on the performance of the economy since the last election. It may be convenient for a candidate to note that his or her opponent held office during a period of economic sluggishness. Yet, we must remember that is unrealistic to expect job growth to keep to an upward trajectory, without interruption. Temporary downturns are inevitable, and such dips occurred long before outsourcing's emergence. And, in a dynamic economy, the job market churns constantly. Jobs are shed, and jobs are gained. This pattern held even during the boom years of the 1990s. Millions of jobs were lost, and yet millions more were created.

Figure 12: Employment Churn (1993-1999)



Source: Bureau of Labor Statistics

Today's jobseekers may look back longingly at the 90s, but let us not forget that that was also the time when workers were exposed to a force much more revolutionary than offshore outsourcing—the Internet. The Internet introduced new technology that greatly expanded trade. With a click of a mouse consumers could disregard the restrictions of geography. They could purchase something across the world just as easily as purchasing something across town.

The Internet terrified many brick-and-mortar companies, and many professions such as travel agent struggle to survive in the face of new online competitors like Priceline and Orbitz. Many jobs were lost, and yet new jobs emerged. Today's want-ads offer "Web designer" and "Internet engineer," employment categories that did not exist a decade ago.[41]

If, during the Internet's early days, President Clinton took up the fight against this new threat to jobs, what would have become of today's Internet workers? Would we have been better off stalling the Internet's emergence?

Trade's habit of creating more than it destroys stretches back well before the last decade. During the last century, farmers' share of the American workforce has fallen from 40 percent to 3. And during the past 50 years we've lost over a quarter-million mining jobs.

What became of all those Americans who would have been farmers or miners? Are they unemployed? Since the United States has grown in population but still managed to keep unemployment relatively low, it's more likely that those would-be farmers and miners have different, more comfortable, and better paying jobs.

During the last 50 years while mining jobs dwindled, our nation gained 78 million service-sector jobs. Today, 19 times more Americans work in finance than in mining, 22 times more work in hospitality and 54 times more work in heath and education.

It's often difficult to track job growth by a particular occupation, because many of today's jobs were created recently. Americans hold millions of jobs that did not exist a century ago.

Table 5: Newly Created Jobs

Occupation	Number of Americans Employed
Aircraft mechanic	128,000
Fitness worker	299,000
Software engineer	758,000
Aerospace engineer	82,000
Real estate agent	850,000

Figures for 2003, Source: Bureau of Labor Statistics

And many traditional jobs—far from being outsourced into oblivion—are more plentiful than ever.

Table 6: Employment Gains in Traditional Employment (1992-2002)

Occupation	Employment Gains	Percent Change
Nurse	+ 512,000	+ 28
Hairstylist/Cosmetologist	+ 146,000	+ 19
Architects	+ 60,000	+ 44
Photographers	+ 49,000	+ 38

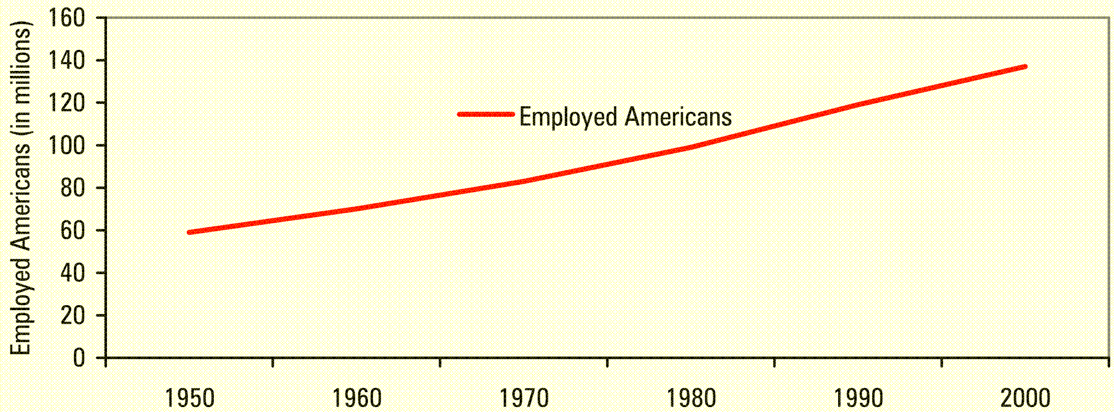
Source: W. Michael Cox and Richard Alm, "A Better Way: Productivity and Reorganization in the American Economy," Federal Reserve Bank of Dallas, 2003 Annual Report.

While it can be useful to note short-term job market fluctuations, one must not let short-term performance obscure larger trends. It is also important to take a step back and observe the big picture, which typically reveals that periodic downturns exist within the larger trend of growth (See Figure 13).

Of course the specific kind of trade called outsourcing has been only one of countless factors that have expanded trade and allow our nation to create more jobs than it destroys.

Offshoring saves firms money that they reinvest in expanding operations or starting new projects. It creates new markets, and spurs innovation, all of which help create more jobs.

Figure 13: U.S. Job Growth 1950-2000



Figures for civilian non-institutional population over age 15.

Source: U.S. Census Bureau: http://www.census.gov/statab/hist/HS-29.pdf

Outsourcing's Job Creation Side: How Does it Work?

The McKinsey Global Institute estimates that for each dollar spent on offshore outsourcing, the United States receives $1.12 to $1.14 in return (see Figure 14).[42] Notably, McKinsey finds that rigid labor laws can compromise the positive effects of offshore outsourcing. If, for example, the German economy were as flexible as the United States, it too would gain from offshore outsourcing. Yet because it is so difficult for German workers to find new jobs, Germany receives only E0.8 for each offshored Euro.

Outsourcing creates American jobs by:

1. Reinvesting cost savings: Like any innovation that improves efficiency, outsourcing allows a business to do more with less. As costs fall, a business can expand by doing more of what it was doing already, or it can expand into related areas, by providing new goods and services. In either case, outsourcing encourages expansion, and expansion leads to new job openings.

Still, some are not confident that we can connect the dots from efficiency gains to job growth. They assume that a company's bottom-line concerns are at odds with the interests of jobseekers. However, it is unlikely CEOs would simply sit on the cost savings that outsourcing yields. It's far more likely they will reinvest savings in anticipation of even bigger profits. After all, Bill Gates and Richard Branson did not simply sit on their first million. Since reinvestment spurs job growth, in order to accept the efficiency gains/job growth link one must simply assume that corporations are self-interested. For most of us, this is not a huge leap. And even if savings are not reinvested in jobs, they will go toward higher salaries, which will increase consumption or savings, and, ultimately investment. In any event, the money does not simply disappear.

Take the case of Delta Airlines. Delta outsourced 1,000 call-center jobs to India, saved $25 million in the process and then hired 1,200 Americans for higher paying reservation and sales positions. Notably, the company outsourced without laying off any employees.[43]

Donaldson Co. Inc. is a Minnesota-based company that makes filters that are used as electronic components in computers, MP3 players, and digital video recorders. Facing competition from overseas manufacturers with much lower prices, the firm shifted production to China. But the design work is done in America, by Donaldson's highly paid team of engineers, chemists, and designers. Offshoring production helped increase Donaldson's U.S.-based employment by 400 employees since 1990. What if the company had refused to go offshore? "We'd be out of business," says an executive.[44]

2. Opening new markets: The McKinsey Global Institute notes that outsourcing creates American jobs in ways that do not necessarily receive much attention. For example, outsourcing creates new markets for U.S. companies. Foreign companies that provide offshore services need to purchase everything from computers to financial and legal services, and they become fast-growing consumers of U.S. goods and services.

3. Creating new goods and services: American jobs can also grow when American companies' offshore sites invent new technology:

> *The Palm Pilot version of Adobe Acrobat was developed in Adobe's center in India. Intel's India campus has produced 62 patents for semiconductors, telecom switching and routers. IBM's India office has produced 85 patents.*[45]

The telecom equipment company Airvana recently opened an office in Bangalore, which will complement work done at its Massachusetts headquarters. The Massachusetts team develops the next generation of the company's technology, while the Bangalore team improves the existing product. "They are adding bells and whistles that could not be added otherwise because it would not be cost effective," says the company head.[46]

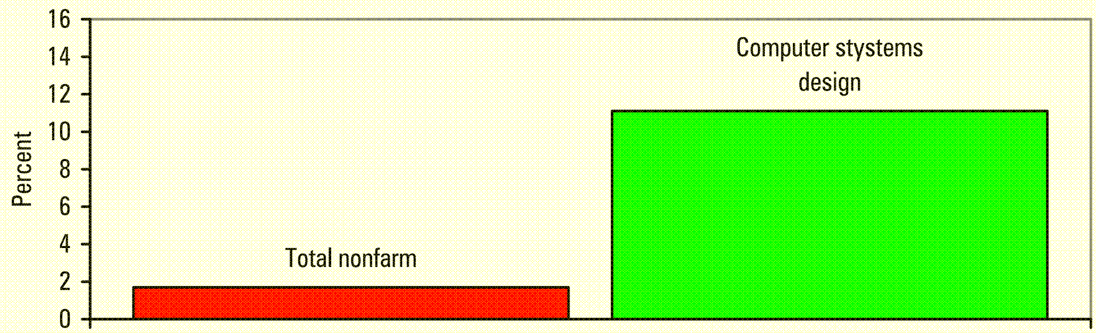
New technologies represent a new source of wealth and jobs. American companies market and distribute these new technologies, producing American jobs in the process. Outsourcing has even become its own industry. In Los Angeles, the top three fastest growing private companies are newly emerging players in the outsourcing industry.[47]

5. Misconception: Outsourcing destroys high-end jobs.
Reality: Few high-end jobs are at risk, and outsourcing will help create more high-paying jobs than it destroys.

Some argue that while past expansions of trade or technology affected low wage workers, today's new wave of outsourcing threatens even highly educated white collar workers.

Certain technology professions have experienced job losses in recent years. But these losses came after the dot com burst, the Y2K technology job build up, and after a decade-long expansion of technology employment.

Figure 14: Annual Growth in Employment, 1990-2001



Source: United States Government Accountability Office, "International Trade: Current Government Data Provide Limited Insight into Offshoring of Services," GAO-04-932, September 2004.

Between 2000 and 2003, at-risk jobs fell slightly (0.1 percent), but management jobs accounted for most of this drop. While management jobs are categorized as "at risk," these are not typically the kinds of jobs that go overseas. Many of the occupations at the heart of the white-collar outsourcing debate have enjoyed recent employment growth. For example, computer and mathematical employment grew by 2 percent from 2002 to 2003.[48]

The good news is today high-paying jobs are more plentiful than ever. From 1983 to 2002, management and professional specialty jobs have increased by 80 percent. These kinds of jobs account for a nearly a third of total employment, a substantial jump from two decades ago when they comprised about a quarter of all jobs.[49] Take a wider view, and we see that expanded trade offers more than just better paying jobs. It also offers safer and more fulfilling jobs (see box).

We are witnessing the latest evolution of creative destruction. Just as was the case with past innovations, some jobs are lost, but more and better jobs are created. Since 1999, 70,000 computer programmers have lost their jobs, yet, at the same time, companies created 115,000 higher paying jobs in software engineering.[50]

Not Just Better Pay

Safer jobs: As the market evolves, we don't just exchange fewer jobs for more; we also trade up for safer, more comfortable jobs. Since today's office mates squabble over a couple of clicks on the thermostat, it's a good thing few of them will have to find out how they'd survive in, say, a mineshaft:

> *When the miner comes up from the pit his face is so pale that it is noticeable even through the mask of coal dust. This is due to the foul air that he has been breathing … Every miner has blue scars on his nose and forehead, and will carry them to his death. The coal dust of which the air underground is full enters every cut, and then the skin grows over it and forms a blue stain like tattooing, which in fact it is.*[51]

Our nation has lost many mining jobs, but gained even more service sector jobs in which soot-filled lungs, facial scars and fatalities are rare. In 1930, the worker fatality rate (deaths per 100,000 workers) stood at 38. By 1995, the figure dropped to 4.[52] Indeed even mining is today much safer than when George Orwell reported on its many risks.

More fulfilling jobs: Historically, we've had little opportunity to link work with fulfillment. Even most of our grandparents worked to live, often taking any available job. You weren't supposed to actually like your job—work was simply a way to put food on the table and a roof over your head. Today, with our bellies full and most other basic needs met, jobseekers go through an entirely new decision-making process: Should we pursue the career that pays the most, the one that's the most fulfilling or some mixture of the two? That we even pause to consider this question reveals great progress.

Our wealthy society allows more people to use their backs less and their brains more. If you want to be a designer, an editor or a biologist, today's society will value your skills more than the industrial or agrarian societies of days gone by. Those who find fulfillment in helping others will also find plenty of opportunities, from teaching to physical therapy or counseling.

Looking toward the future, the jobs that are most likely to be outsourced are those below the U.S. average wage.[53] There are many functions that companies simply will not consider for outsourcing, and most involve high-end jobs. One survey of multinational companies finds that a majority of respondents say they will not outsource high-end functions like financial reporting and analysis. Meanwhile those jobs companies are most likely to outsource are lower-end and easier to standardize, such as IT support and development and customer service.[54] The Bureau of Labor Statistics expects job growth in technology fields to be the fastest growing category for the rest of the decade, and job growth is expected to continue to far outpace job loss.[55]

6. Misconception: Outsourcing is a one-way street.
Reality: Millions of Americans have jobs thanks to "insourcing."

The debate about offshore outsourcing has focused on jobs leaving the United States. By definition *offshore* outsourcing does, in fact, address only the outflow aspect of trade. But we should not define ourselves into a corner. Let us not forget that offshore outsourcing is merely one component of the larger process of trade.

Insourcing represents an often-overlooked aspect of trade that creates jobs at home. Americans may regard outsourcing as a one-way street, where jobs travel to distant lands never to return. But like international trade in general, outsourcing goes both ways: U.S. companies send jobs to foreign nations and foreign companies send jobs to the United States.

U.S. companies may find themselves enticed by the comparatively low labor costs in foreign nations. Likewise, foreign companies look to the United States and like what they see, even though they are typically enticed by different factors. Foreign companies may seek lower tax and regulatory burdens, a highly skilled labor pool, political stability, a court system that enforces contracts, strong infrastructure, a vast consumer market, and so on. Indeed, the United States has much to offer foreign companies.

Between 1990 and 2002 the United States received $800 billion in service-sector foreign investment, more than the next two largest recipients combined.[56] According to the Organization for International Investment, U.S. subsidiaries of foreign companies employ 6.4 million Americans, a figure that has grown dramatically during the past 15 years. In other words, we likely gain many more jobs from insourcing than we lose from outsourcing.

Insourcing Creates Jobs

The following is a small sample of the insourcing that has occurred since 2003:

Alabama: Honda North America, Inc. announced expansion of its Alabama plant at the end of 2002 – a doubling to 300,000 Odyssey minivans and V6 engines. Line 2 starts this spring with full production by the end of 2004. This brings Honda's employment in Alabama to 4,300.

California: BAE Systems, the U.S. subsidiary of the British high-tech company, will employ approximately 550 people in its new Los Angeles facility. The office and prototype development building houses BAE's Integrated Solutions unit and opened in May, 2003.

Connecticut: Boehringer Ingelheim Pharmaceuticals, Inc., the U.S. pharmaceutical subsidiary of Germany-based Boehringer Ingelheim Corporation, is planning to expand its facilities on its existing 294-acre campus in Ridgefield. The project is expected to create 500-700 new jobs over the next six years.

Michigan: Global Engine Alliance, a joint venture between Germany's DaimlerChrysler, South Korea's Hyundai and Japan's Mitsubishi, is building a $400 million facility in Dundee. The plant will manufacture aluminum engines for its owners' vehicles. The facility is expected to create 172 new jobs in its first year of operation and 400 new jobs over a five-year period.

Texas: Samsung, a U.S. subsidiary of a South Korea-based company, is adding 300 high-paying, high-tech jobs to the current 930 positions at its Austin semiconductor plant. While Samsung is investing $500 million total, about $400 million will go to upgrading the plant's semiconductor fabrication equipment.[57]

Insourcing brains

Insourcing is not simply a matter of established foreign companies setting up shop on American soil. Foreigners who feel stifled in their homelands often create businesses only after they arrive to the United States.

Other nations often scorn "brain drain," in which some of their most talented and driven men and women leave to find success in America. These talented foreigners arrive on our shores, start businesses, patent inventions, and hire Americans. Indeed some of our most American tech titans were founded by immigrants.

Table 7: Brain Gain = Job Gain

Name/Title	Company	Employees	2003 Sales
Andy Grove, Co-founder and Chairman	Intel	79,700	$30.1B
Vinod Kholsa, Co-founder	Sun Microsystems	35,000	$11.4B
Jerry Yang, Co-founder and Director	Yahoo!	5,500	$1.6B
Sergey Brin, Co-founder and President	Google	1,600	$1.06B

Source: Hoovers Online

Martine Kempf developed technology that allows handicapped people to drive cars, and operate wheelchairs using only voice commands. The technology also allows micro-surgeons to move surgical microscopes with voice commands instead of foot pedals. Yet she grew frustrated trying to develop and market her inventions in her native France. Eventually, she left for the United States, where she quickly obtained a business license. One year later, she was selling her voice-activated products in nine nations.

"This is what I call the land of opportunity," Kempf says of America. "That's absolutely fantastic. You cannot get this probably anywhere else in the world."[58] Kempf says her departure "was a sort of alert that things had to change, and it hasn't happened." During the 1990s, hundreds of thousands of white-collar workers and entrepreneurs decided to leave France.[59]

Closer to home, Mexico's young white-collar workers are dismayed by a regulatory jungle that stifles entrepreneurs. They too seek better opportunities in the United States. "The problem is that we don't provide, as a country, the possibilities for an engineer to make his little shop and have something profitable," says a Mexican business analyst.[60]

The magnetic effect America has on other nation's best and brightest helps fuel an innovative and robust economy. The United States can gain even more by improving the features that lure foreign investment.

7. Misconception: Companies could simply refuse to go offshore. Reality: Refusing to offshore can mean foregoing expansion or worse.

The decision to outsource can seem puzzling: How could a CEO place greed before saving American jobs? Sure, resisting outsourcing might make production somewhat more expensive, but if the tradeoff is slightly slimmer profits and keeping more Americans employed, it seems heartless to choose outsourcing.

The public debate may cast outsourcing as such, but a business owner's decision may not be a question of outsourcing or not. It may be a choice between outsourcing or foregoing expansion, or even, outsourcing or going bankrupt. Bicycle manufacturer Huffy and Zenith Electronics chose not to send manufacturing jobs overseas, and suffered the consequences. Huffy's earnings slid, and the company recently turned to an investment bank to improve its business strategy. Zenith filed for bankruptcy in 1999.[61]

The decision by Huffy and Zenith to forego outsourcing may have cost more American jobs, but other companies have discovered that outsourcing can actually save American jobs.

Outsourcing Can Save American Jobs

- ValiCert avoided bankruptcy by outsourcing jobs to India. The cost savings allowed the hi-tech company to stay in business, and eventually hire more Americans at higher-level positions. Said the CEO, "Without India I don't know if we'd be around today."[62]
- CollabNet has an office in San Francisco and one in Chennai, India. The CEO says that hiring offshore has saved money and allowed his company to keep up with customer demand. "We saved the jobs of the people who are employed in San Francisco by hiring people here [in India]," he says. "I don't know that we would be around as a company if we hadn't done that."[63]
- September 11th hit hard at Integrated Decisions and Systems Inc. After the terrorist attacks, hotel and airline industries cut their demand for the company's software products. The company struggled to stay afloat, and eventually decided to lay off workers and outsource some work to India. Outsourcing saved the company millions, and allowed it to withstand the tough times. "I think it's almost a certainty we would have had to close the company, had we not had the ability to move these jobs offshore when we did, in response to a crisis," says the CFO. "The company would not be here and the 50 jobs that we now have in the United States wouldn't exist."[64]

Any time a company chooses inefficiency in order to save some jobs, the decision may actually cost more jobs in the long run. This is particularly true today, as competition comes from all corners of the globe. And the issue of efficiency is the same, regardless of whether improved efficiency would come from outsourcing or something else, like new technology.

A bank that refused to offer online services because it wanted to protect teller jobs would lose customers to banks that do offer online services. Only growing companies hire more employees, so the bank that makes a decision it knows will make it less competitive will probably not be a source of new jobs. Even the generosity that motivated the decision to avoid online banking would prove misplaced, for such efficiency-boosting technology has given birth to new kinds of jobs. In fact, the rise of online banking has coincided with a rise in banking industry employment.[65]

And outsourcing need not be viewed through the us-vs-them lens. Outsourcing is not a zero-sum game in which foreigners can only benefit at the expense of American workers. Between 1991 and 2001, U.S. companies that expanded their overseas employment also increased their American workforces by 5.5 million employees.[66]

8. Misconception: Outsourcing is driven by businesses looking for cheap labor. Reality: Where a company decides to do business is determined by many factors.

Cost savings does appear to be the major driver behind offshore outsourcing, and lower labor costs are a significant—perhaps the most significant—method for trimming costs.

But if businesses were interested only in cheap labor, third world nations would be flooded with foreign investment. Yet roughly 70 percent of foreign investment funnels into developed nations. During recent years, while India was making headlines, U.S. investment actually increased faster in Ireland.[67] In fact, the United States invests more in Ireland than in China, the Philippines and India combined.[68]

Foreign direct investment and offshore outsourcing are related, but distinct concepts.[69] Yet focus directly on outsourcing and the pattern remains the same. Although outsourcing destinations like India are growing in popularity, U.S. multinationals are much more likely to outsource to Canada and the United Kingdom where labor costs are comparatively high.[70]

Table 8: Where America Outsources*

Rank	Nation	% of U.S. outsourcing
1.	Canada	24.3
2.	United Kingdom	19.3
3.	Japan	6.8
4.	Germany	4.6
5.	France	3.2
6.	Mexico	2.9
7.	Netherlands	2.5
8.	Australia	1.9
8.	India	1.9
10.	Hong Kong	1.6

* U.S. unaffiliated imports of business, professional, and technical (BPT) services, by nation of origin, 2002. The GAO notes that BPT services are those that are generally associated with offshoring, such as accounting, bookkeeping, computer programming, research and development. Affiliated trade occurs between foreign affiliates and their parent companies. This kind of data is not broken down by nation, but unaffiliated data are, and so unaffiliated data are used as a proxy for offshore outsourcing.

Source: Source: United States Government Accountability Office, "International Trade: Current Government Data Provide Limited Insight into Offshoring of Services," GAO-04-932, September 2004.

And since a business endures many different kinds of expenses, there are many ways to reduce costs. Businesses want lower costs, period. They do not particularly care where the cost savings are found. For example, lower costs can come from higher productivity, higher quality, and greater reliability. There are also many costs associated with tax policy and regulation. If it makes sense for a company to lower costs by moving to an area with lower taxes and regulations, it will do so.

More fundamentally, reducing costs is merely one route to the goal of any business: increased profits. A key way to boost profits is to provide a more appealing service, that is, to increase quality. News reports focus so much on lower costs that they overlook the fact that outsourcing typically brings quality improvements. In a survey of 45 companies, nearly 70 percent of respondents reported that outsourcing (both onshore and offshore) resulted in increased quality. The authors discovered that

> *[T]he long held view—"went for cost, stayed for quality" about moving processes outside the company (in some cases outside the country) is too simplistic. Rather we found that "went for cost and quality, stayed for continued quality and competitive costs" is more in line with the strategy that these companies employed.*[71]

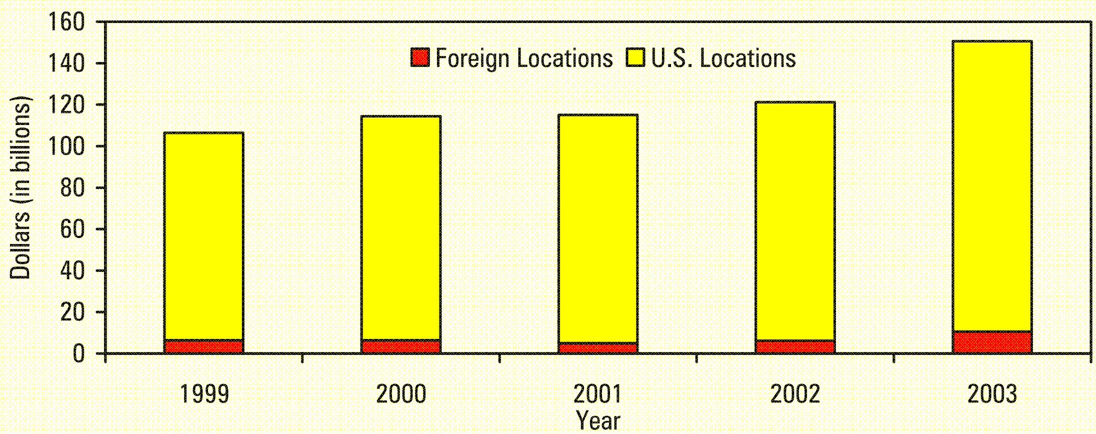
Apart from low costs and high quality, businesses seek educated workers, workers who speak their language, access to markets, proximity to related industries, political stability, strong infrastructure, cultural compatibility, and so on. Since their final aim is increased profits, businesses outsource not so much for cheaper labor, but to find the bundle of qualities that suits them best.

9. Misconception: Government-sector offshore outsourcing is widespread. Reality: Government-sector offshore outsourcing is especially rare.

Though growing, the amount of private-sector offshore outsourcing is still quite small. Government-sector offshore outsourcing is smaller still.

Although precise figures are hard to come by, offshore outsourcing by the federal government has increased in recent years, from $6.4 billion worth of service contracting in 1999 to $10.6 billion in 2003. [72] Yet offshore outsourcing has remained a small portion (about 6 percent) of total federal government outsourcing.

Figure 15: Is Government Work Going Overseas?
Dollar Value of Federal Government Procurement of Services by Location



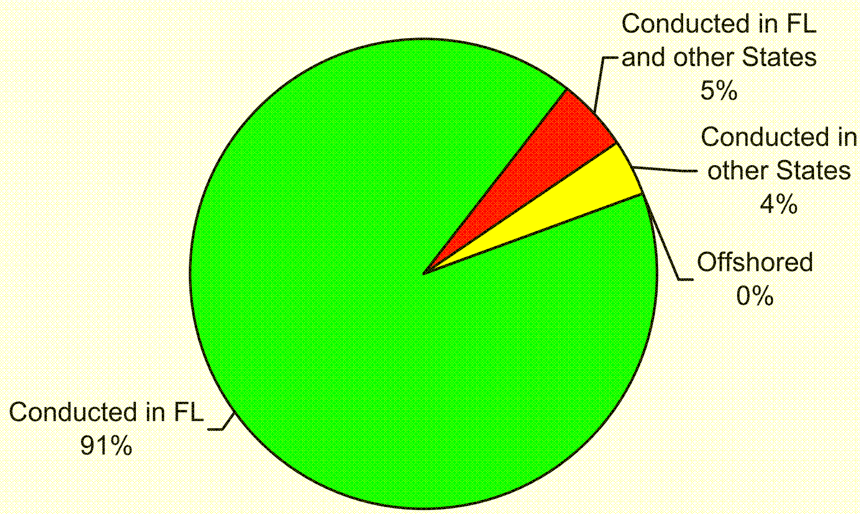
Source: United States Government Accountability Office, "International Trade: Current Government Data Provide Limited Insight into Offshoring of Services," GAO-04-932, September 2004.

It is even more difficult to assign a dollar figure to the amount of offshore outsourcing done by state governments, largely because the practice is so uncommon. For example, an analysis by the California State Auditor concluded that the available evidence suggests "the state is spending little on services performed offshore."[73] An anti-outsourcing group recently documented roughly $75 million worth of government work sent overseas by the 50 state legislatures.[74] Although the report was intended to stir fears about the rise of offshore outsourcing, it actually revealed how infrequently states make use of the practice. Seventy five million dollars may seem like a huge amount of money, but state and local governments contract for over $100 billion in services, so offshore outsourcing does not even amount to one-one hundredth of a percent of government outsourcing.

Sidebar: Florida's Outsourcing Experience—Not Going Offshore

Of 138 outsourcing initiatives conducted since 1999, none have gone offshore:

Figure 16: Where Florida Government Outsourced Services are Conducted



Source: The Center for Efficient Government

And yet, much like the private-sector variety, the outcry over government outsourcing has been grossly disproportionate to its actual occurrence. Most of the anti-outsourcing bills under consideration take aim at the tiny amount of offshoring done by states, thus much effort is devoted to a very small part of actual operations.

In some cases states have offshored services, only to bring them back after getting stung by bad publicity. Last year, North Carolina legislators voted to spend $1.2 million to bring 34 child support call center jobs back from India. Perhaps the case that received the most attention was New Jersey's decision to bring back a dozen call center jobs that had gone overseas, a move that cost taxpayers $100,000 per job. Indiana's cancellation of a $15 contract million was probably even more costly.[75] The cancelled bid was $8.1 million less than the next closest competitor, and by one estimate, state taxpayers paid $162,000 for each of the roughly 50 jobs "saved."[76]

Decisions that place more importance on preserving government jobs than on cost savings reveal a troubling break from the central mission of government—efficiently providing services.[77]

Should government provide jobs or services?

Imagine if government could administer services for free. Imagine the cost savings. Imagine how many jobs entrepreneurs could create with all the extra cash in hand.

If such a proposal were possible, would lawmakers regard it as the greatest efficiency innovation in the history of governance or as a threat to jobs? Of course, it is impossible to administer government services for free, but it is very possible to administer them for less. Governments use competition to find the best deal for the taxpayers, and if the best deal comes from a firm that does some of the work offshore, that conforms to the goals of procurement policy. Government procurement is about efficient use of tax dollars; it is not a jobs program.

We cannot give government two conflicting goals—providing services and providing jobs—and expect both to be done equally well. At some point one goal must be compromised to benefit the other. The more a government operates as a jobs program, the more leery it will grow toward efficiency improvements. And unlike a wasteful private company that hurts only itself by sinking into bankruptcy, a wasteful government just keeps sinking, dragging others down with it.

Instead of charging taxpayers $162,000 for each job brought back from India, Indiana could have spent tens of thousands in severance pay and job training for each outsourced worker. The state could have used the savings for higher priority issues, returned the savings to taxpayers, or devised some combination of the two.

Citing the outrage the Defense Department provoked when it sought to purchase black berets from China, a Commerce Department official notes how the controversy surrounding offshore outsourcing can compromise a department's core mission:

> *Lawmakers were incensed that U.S. tax dollars in the Defense Department, of all places, were not being used to support American manufacturers, and the hats were procured from a domestic supplier. Yet unfortunately this question is a bit more complicated. Since even the Defense Department faces a ceiling on its budget, Defense planners are forced to make tough decisions every day. Every dollar spent on clothing is a dollar less for improving soldier's pay (to keep military families off food stamps), supporting forward deployments, designing new defense systems to better protect our men and women in harm's way, and improving the accuracy of our precision-guided munitions to minimize noncombatant casualties.*[78]

Even so, there is some indication that legislators have begun to examine offshore outsourcing with more sober eyes. Kansas lawmakers were initially so outraged by a plan that would send food stamp call center jobs overseas, that they moved to ban it. Once they learned the ban would make providing the service 40 percent more costly, they discarded it. The governors of Maryland and Massachusetts vetoed anti-outsourcing bills passed by their legislatures in 2004, and Governor Schwarzenegger did the same in California when he shot down five such bills.[79]

If lawmakers choose to regard government as a jobs program, there will always be opportunities to "create" jobs by promoting wastefulness. For example, replacing copier machines with human copyists would certainly produce many job openings. But each concession to wastefulness makes government more burdensome, and the chance of future job growth—in private-sector areas that actually improve living standards—less likely.

10. Misconception: Only Republicans defend offshore outsourcing. Reality: Many well-respected voices across the political spectrum have defended offshore outsourcing.

Many nonpartisan and non-Republican voices have criticized the way the outsourcing debate has been framed.

Former Clinton administration Labor Secretary Robert Reich argues:

> *There is no sense for us to try to protect or preserve high-tech jobs in America or block efforts by American companies to outsource. Our economic future is wedded to technological change, and most of the jobs of the future are still ours to invent.*[80]

According to the Progressive Policy Institute:

> *The offshoring panic … has triggered a spate of ill-conceived legislation aimed at punishing companies that send jobs overseas.*
>
> *Such proposals are fundamentally flawed. First, they raise costs for taxpayers, just as restrictions on imports raise costs for consumers … Moreover, restrictions designed to curb offshoring can easily have unintended consequences.*[81]

Indeed, a California legislative office commissioned a report from the nonpartisan Public Policy Institute of California that found:

> *[T]he fervor over offshoring's occurrence appears out of proportion to its incidence.*
>
> *It is likely that "outstating"—outsourcing to another state—is a much more important phenomenon than is offshoring for California.*
>
> *Because of the dynamics of the U.S. economy and offshoring's expected effect on productivity, the overall, longer-run effect of offshoring may be to increase living standards at home.*[82]

Yet the legislature went on to pass several anti-outsourcing bills. The *Los Angeles Times* editorial staff, which frequently sides with the state's Democratic leaders, spoke out against the bills calling them "wrongheaded," and suggested that Democratic legislators had not read the report.[83]

Since outsourcing is merely a version of trade, it is worth noting that President Bill Clinton, the most successful Democrat in recent history, expanded international trade during his presidency. Indeed, three economists are Democrats for every one that is a Republican, and yet among them there is broad agreement that free trade benefits society.[84]

The dynamics of outsourcing are more complex than media accounts and stump speeches portray. Offshore outsourcing helps create more and better jobs, but its destructive side gets so much more attention. Why?

Part 3

Why is Offshore Outsourcing So Feared?

Politicians and journalists tend to focus on the destructive side of offshore outsourcing, and it's easy to understand why. Many fear that outsourcing has muddied the route to success:

- One hundred and fifty years ago we thought hard work and a plot of land were the only ingredients needed to make a good life. But that changed.
- Fifty years ago we thought all you had to do was land a job with a corporate giant—a GE or Ford—and work hard, and you would have a job for life. But that changed.
- Twenty-five years ago we thought college was the answer. Get a college degree and work hard, and you could always find a good, high-paying job. But many worry that even that has changed.

Today, job security is rooted, not in a college degree or employment with a corporate giant, but in skills. Workers must be able to offer skills that employers find valuable, and it is up to each worker to determine what those skills might be. Today's jobseeker has more options than ever, but sometimes so many options can feel overwhelming. Some fear that there is no longer one clear, failsafe path to success.

Vince Kosmac embodies some of the new frustrations jobseekers endure. The two-time victim of outsourcing tells his story in a recent *Time* magazine cover story:

> *Vince Kosmac of Orlando, Fla., has lived both sad chapters of outsourcing--the blue-collar and white-collar versions. He was a trucker in the 1970s and '80s, delivering steel to plants in Johnstown, Pa. When steel melted down to lower-cost competitors in Brazil and China, he used the G.I. Bill to get a degree in computer science. "The conventional wisdom was, 'Nobody can take your education away from you,'" he says bitterly. "Guess what? They took my education away." For nearly 20 years, he worked as a programmer and saved enough for a comfortable life. But programming jobs went missing two years ago, and he is impatient with anyone who suggests that he "retrain" again. "Here I am, 47 years old. I've got a house. I've got a child with cerebral palsy. I've got two cars. What do I do--push the pause button on my life? I'm not a statistic.*[85]

Many Americans share Kosmac's anxiety. After all, in the new economy it can be difficult to map out the path to success. Kosmac represents offshoring's victims, but he also embodies why the public debate will focus more on the destructive side of offshore outsourcing and less on creation—destruction is obvious, but creation is subtle.

Job Destruction is Obvious; Job Creation is Subtle

When outsourcing strikes, its victims are widely known. Reporters know they have a compelling story. Television cameras can absorb the frustration in the face of the suddenly jobless mother or father. Politicians can point to any number of Vince Kosmacs and express outrage at the system that would allow such injustices to occur. Even those not affected by outsourcing will take note, for they wonder if their job might be next. Indeed, the cover story that included Vince Kosmac carried the unsettling title, "Is your job going abroad?"

Workers who feel threatened by outsourcing are an organized group with tremendous motivation to rally, lobby their congressional representatives, and volunteer their time to anti-outsourcing efforts. It is no wonder outsourcing has stirred such fear, and where there is fear, there will be politicians willing to fight for laws that allay those fears. When John Kerry famously decried "Benedict Arnold CEOs" he signaled that outsourcing would be a key issue throughout the presidential campaign and beyond.

Yet all the public fears, all the media stories and all the proposed laws understate the upside of outsourcing. And it's easy to understand why—creation is subtle. It's easy to spot the victims of outsourcing, but it's difficult to spot the beneficiaries.

Usually, reporters cannot interview those who benefit from outsourcing, television cameras cannot show their smiling faces and politicians cannot champion their cause. Unions organize to protect today's jobs, not the jobs of the future, so they too have little incentive to stand up for innovation. Reporters and politicians typically do not know who the beneficiaries of outsourcing are. In fact, the beneficiaries themselves do not usually realize that they have been aided by outsourcing.

When a company fires American workers and then hires foreign replacements, the fired workers curse outsourcing. But when a company outsources, saves money, and then invests the cost savings to hire more workers, the newly hired workers do not cheer outsourcing. They have little or no knowledge of the events that created their jobs. They're simply pleased to have jobs.

When outsourcing allowed Delta to hire more workers at better pay, the new workers were likely unaware of what occurred behind the scenes prior to their arrival. With few human representations of outsouring's job creation side, the public debate tilts toward destruction.

Even if they were on the lookout for outsourcing success stories, politicians and journalists would still have a difficult task. Outsourcing contributes to an environment that encourages job growth, but it is rarely the sole reason behind any particular job opening. Outsourcing is usually only one of many factors that contribute to a company's ability to create more jobs. Like trade in general, outsourcing helps make an economy more efficient, and because of greater efficiency countless goods and services (from food to computers to oil changes) cost less to produce and purchase.

It would be impossible to credit efficiency gains of any one product or service for the creation of any particular job—was the cheap and abundant supply of pens and paper the tipping point that allowed an employer to forego extra office supply expenses and hire another employee instead? International trade is credited with dropping technology hardware costs 10 to 30 percent, and lower technology prices helped stimulate the economic expansion of the 1990s.[86] Yet who can provide a list of names of people who have jobs thanks to international tech-sector trade? The process of job creation relies on many factors working together. The process is subtle but powerful, and the cumulative effect makes it easier for jobs to grow.

Policymakers should allow outsourcing to follow in the footsteps of its relative, international trade, which has an impressive job creation record. There are, after all, much more serious threats to job growth, namely outforcing.

Part 4

How to Address Outsourcing: Stop Outforcing

Some jobs leave town because the natural evolution of the market allows them to be done somewhere else; others get chased out by costly policy decisions, that is, they are out*forced.*

When jobs go overseas, outsourced workers and media reports tend to blame greedy corporations, yet they assign far less blame to those who created a climate that is hostile to job growth.

A. Outforcing: America vs. the World

America has long benefited from "insourcing" and "brain gain" in which talented foreigners come to our shores to escape the stifling environment of their homelands. But as other nations adopt market reform, they become friendlier to entrepreneurs and make inroads into what has traditionally been an American advantage. (For example, it was regulatory reform in India in the early 1990s that prompted many multinational corporations to set up operations there.)

In the United States federal, state and local tax policies, convoluted labor laws and policies, outdated licensing and permitting requirements, unduly burdensome land use and environmental regulations and many other layers of the regulatory apparatus have driven up the costs of doing business, and thus creating jobs, making other nations more competitive at producing some goods and services. Increasingly this suite of policies raises costs to the point of *outforcing* jobs to other nations.

Outforcing persists, to a large degree, because policymakers have been slow to address growing problems. Too often American policy seems to operate on the basis of decades-old assumptions about our nation's place in the world, such as:

- The United States is the best place to find educated workers.
- U.S. policy provides the best environment for job creation.
- Other Western democracies have rigid economies that are unfriendly to entrepreneurs.

While the preceding assumptions still hold a good deal of truth, they are not as true as they used to be. In areas key to international competitiveness, the United States has slipped while the rest of the world has jumped in improvement. This year marks the first time the United States was not among the world's ten freest economies. Nations like Estonia and Ireland, which just a decade ago lagged behind the United States in economic freedom, have now shot ahead.[87]

As other nations continue to embrace reform, legislators at every level of government should work to improve our nation's innovation-friendliness to ensure our reputation matches reality. Legislators must see the world as it exists today, and not base policy on outdated assumptions. The same policies that guard against outforcing will also encourage more insourcing.

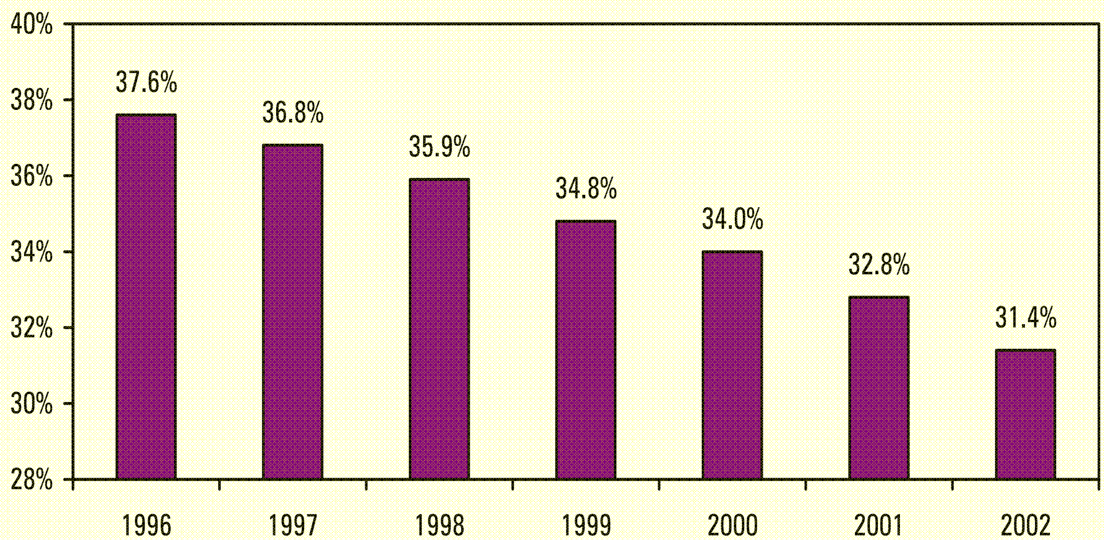
The factors that contribute to outforcing are varied, and a comprehensive analysis of such factors is beyond the scope of this study. However, let us briefly examine some of the more significant factors.

1. High Federal Corporate Tax Rates

By many measures the United States is still a leader in providing an atmosphere that businesses find attractive for investment, but corporate tax policy is no longer one of them. Since corporate tax rates play a significant role in attracting foreign investment (insourcing) and retaining U.S. companies, the United States can improve its competitiveness by reforming corporate taxes.

During the past decade, other developed nations have lowered corporate tax rates in an attempt to chip away at their reputations for entrepreneurial unfriendliness.

Figure 17: Average Top Corporate Income Tax Rate in Organisation for Economic Co-operation and Development Nations



Note: Calculations based on KPMG data. Unweighted averages.
Source:http://www.cato.org/cgi-bin/scripts/printtech.cgi/pubs/tbb/tbb-0204.html

Some nations with particularly rigid economies, such as France, Germany and Russia, have led the developed world in rolling back policies that stifle job growth.[88] Many are surprised to learn that the United States has a higher corporate tax rate than some social democratic nations, such as Denmark, Germany and Sweden (See Table 9).

Table 9: Corporate Tax Rates by Nation (2002)	
Nation	**Corporate Tax Rate (%)**
Belgium	39
Canada	38
Italy	36
United States	**35**
France	33.3
Australia	30
Denmark	30
Japan	30
United Kingdom	30
Finland	29
Norway	28
Sweden	28
Germany	25
Ireland	16
Switzerland	8.5

Source: Office of Tax Policy Research

An analysis of 500 multinational corporations confirmed the obvious: "average effective tax rates have a significant effect on the choice of locations and the amount of capital invested there."[89] Not only are companies sensitive to tax rates, they are growing increasingly sensitive to them.[90]

2. A Faltering Education System

While today's fears about losing high-tech jobs to offshore outsourcing may be overblown, a faltering education system will make employers increasingly likely to look overseas for skilled labor. This represents a significant shift in how entrepreneurs view our labor force. The United States has long deserved its reputation for providing businesses worldwide with first-rate workers. Yet there is danger in assuming our past reputation will carry on into the future.

America's students have fallen behind the rest of the world, especially in math and science. A 2004 report from the Organisation for Economic Co-operation and Development (OECD) found that American students ranked 24th out of 29 nations tested in mathematics literacy and problem-solving. A quarter of American students performed at or below the lowest level of competence. Even the ranks of America's best and brightest were comparatively thin. Worldwide, about 4 percent of all students who took the test scored at the highest level, yet only 2 percent of American students reached this level.

What may be particularly disheartening is that American students' ranking in math and science falls more the longer they stay in school. While our 4th graders compare quite well with the rest of the world, our 12th graders are near the bottom.[91]

A report by the American Electronics Association argues that as American students continue to fall behind foreign students, high-tech firms will look to foreign nations not so much for cheaper labor, but for smarter labor.[92]

Recently, Federal Reserve Chairman Alan Greenspan voiced concerns about our nation's education system:

> *[W]e have developed a shortage of highly skilled workers and a surplus of lower skilled workers … More broadly, in considering the issue of expanding our skilled workforce, some have a gnawing sense that our problems may be more than temporary and that the roots of the problem may extend back through our education system.*[93]

Prominent leaders of the tech industry have weighed in as well. According to Intel CEO Craig Barrett:

> *The most intelligent thing the U.S. government can do is to beef up the education system. The K-12 system does a good job of weeding out any students interested in math or science.*[94]

Microsoft CEO Steven Ballmer says the dwindling numbers of American students graduating in technology fields is his top concern.[95] Recently, Bill Gates was more explicit with his frustration. While addressing our nation's governors he called U.S. high schools obsolete and declared that elected officials should be ashamed of a system that leaves students unprepared for college and technical jobs. Said Gates:

> *Training the workforce of tomorrow with today's high schools is like trying to teach kids about today's computers on a 50-year-old mainframe.*[96]

While the troubled state of education will likely play a significant role in the future of outforcing, we should bear in mind that this process has already begun.

Not Cheaper, Smarter

Case Study: In 1989, Nortel moved on an ambitious expansion plan. The company needed more talented hires, but could not find enough from the pool of American and Canadian students it had turned to in the past.

Said Nortel's general manager:

> *We could see that a serious constraint was going to be the availability of scientific and technical skills. Enrollment in science and technology had already peaked in North America and the college-age population was declining.*[97]

Instead of restraining their plans for expansion, Nortel looked to the global market for technical talent. In the early 90s, the company became one of the first to set up an offshore software development center in India. By the end of the decade more than 1,500 India-based employees were working on Nortel projects.

Researchers have chronicled our troubled education systems for decades, and yet substantive reform has been slow to emerge. Though it will not help those currently in the workforce, policymakers who can finally reverse this course will do much more to aid future workers than those who choose to shake their fists at outsourcing.

3. Innovation-Stifling State and Local Policies

State and local policies play a large role in determining a given area's business climate. In fact, a Forbes Global analysis of the international business climate found it necessary to compare foreign nations not with the United States in general, but with selected U.S. states (New York, Illinois and Texas). The analysis considered many factors that affect a company's cost of doing business, and devised a tax misery index.

Of the three U.S. states considered, New York was highest on the misery index. Its overall rank of 22 made New York more miserable than the likes of Germany (24), the United Kingdom (26) and Ontario, Canada (27). Illinois (34) and Texas (36) were notably less miserable, and yet the business climate in those states was still worse than in nations such as Ireland (39), Australia (42) and India (46).[98]

Table 10: Tax Misery Index for Selected Locations

Overall rank (out of 50)	Location
22	USA (New York)
24	Germany
26	United Kingdom
27	Ontario, Canada
34	USA (Illinois)
36	USA (Texas)
39	Ireland
42	Australia
46	India

Source: *Forbes Global*

It is not surprising that foreign companies looking to invest in the United States and create new jobs are paying attention:

> *Not only are U.S. firms sensitive to the different tax rates abroad, but studies also have found that foreign investors are sensitive to U.S. taxes – especially state corporate income tax rates. These studies find that state tax rates have a significant effect on the location of new plants.*[99]

Within the United States, the levels of corporate taxes demanded by state governments vary widely.[100] The variability in business climate continues when moving from state to local policy. An *Inc.* magazine analysis of U.S. metro areas found that today's job magnets are not so much the established, old-guard cities, but newer areas like Atlanta, Riverside and Las Vegas where the cost of doing business is lower.[101] In fact, many older metro areas have cultivated environments that repel jobs. New York, Boston, Philadelphia and San Francisco made *Inc.*'s "worst places to do business" list.

The consulting firm A.T. Kearney, in a recent report analyzing the effects of outsourcing on the San Francisco area, noted that the region's business climate likely has more impact on the job market than offshoring, and that the high cost of doing business pushes jobs out of the region. The analysis cites San Francisco's overburdened infrastructure system, high corporate tax rates, and the nation's steepest electricity and workers' compensation costs:

> *The region has the highest cost of living in the nation, well above the other cities and regions it competes with and nearly 50% above the national average. High housing costs driven by inadequate supply, are the main culprit, raising the amount that companies must pay to attract and retain their workforce.*[102]

It is probably not a coincidence that falling housing affordability brought by restrictive land use policies caused Portland, Oregon to join San Francisco on *Inc.*'s "worst places to do business list." Likewise, it is probably not a coincidence that Atlanta led the nation in homebuilding during the 90s and topped the *Inc*. magazine business-friendly list.

The causes of outforcing exist at all levels of government, and the general prospects of the American worker would improve most if all levels worked to decrease its prevalence. The good news is each level of government can make gains against outsourcing on its own. State governments need not wait for federal action, and local governments need not wait for state action.

For cities located within states that outforce jobs much can be done to forge a different kind of environment at the local level. Local governments can, for example, reform education and zoning laws and tackle traffic congestion, even if state and federal leaders do not make fighting outforcing a priority.

B. Outforcing: America vs. America

Magazine articles and television programs often feature the image that, perhaps more than any other, represents how Americans view outsourcing: the Indian woman working in a call center and dressed in a traditional sari.

However the true face of outsourcing is far more likely to be found in South Carolina than South Asia. A New York luxury fabric company recently relocated to South Carolina, and the reasons offered by the CEO should sound familiar to those concerned about offshore outsourcing, "You have lower overhead, lower taxes, lower occupancy costs, lower labor costs, lower everything."[103]

As noted earlier, the Bureau of Labor Statistics reports that most outsourced jobs never leave American soil. And surveys of corporate outsourcing confirm that outsourcing is mostly a domestic phenomenon. A recent analysis of outsourcing in California finds that losing jobs to other states is likely "a much more important phenomenon" than losing jobs to other nations.[104] Outforcing pushes jobs out of the United States, but even more often, it pushes jobs from city to city and from state to state.

If legislators seek to allay their constituents' outsourcing fears, should they fight for laws that ban or impede domestic outsourcing? Even if the interstate flow of jobs were stopped, jobs would still dart from one end of the state to another, from county to county and from city to city.

American Governments: Competing among Themselves

Like other nations, America's cities and states compete for capital and jobs all the time. Much like it does in the private sector, competition improves efficiency, customer service, and the end product.

State and local governments try to provide the private sector with an environment that residents and companies find desirable. If taxes and regulations grow too onerous, businesses and jobseekers may simply move to another, more business-friendly area.

It is interesting to note how Americans' migration patterns so closely mirror favorable business climates. Those states that have gained population tend to be the same states that have more entrepreneurial environments, which makes sense, since the number one reason people move long distances is for better job prospects.[105]

Between 1990 and 2000, only nine states experienced declines in native-born population, and population declines correlated with low levels of economic freedom (as measured on an A-F grading scale[106]). Of the nine population-losing states, seven had economic freedom grades of F, another scored a D, and only one had an A.

Table 11: Native-Born Population Losers and Economic Freedom

Population Loser	Grade
California	F
Connecticut	F
Delaware	A
Hawaii	F
Illinois	F
Michigan	D
New York	F
New Jersey	F
Ohio	F

Sources: William F. Frey, *Forbes*, Pacific Research Institute.

Americans will relocate for good jobs, and it is no secret what employers are after. They want higher profits, and they can make more money by increasing revenues or decreasing operating costs. Well-established metro areas like New York and San Francisco may assume they have so many other features that businesses find attractive that they do not have to be especially vigilant about keeping taxes and regulations low and light. Indeed, such areas have huge head starts over many other places as people and businesses have poured into them for centuries. Ports gave these cities access to people and products from around the world, and today those ports have been supplemented by international airports. Our nation's established metro areas still benefit from the momentum of the past: they offer access to huge markets, educated workers and a wide variety of businesses.

But since improved technology allows information to pass quickly and cheaply from person to person regardless of distance, physical location, though still important, is not as important as it once was. The falling cost of air travel also makes physical location less important, for it is now easier to visit clients in other cities. Americans no longer have to huddle around port cities; they can venture to landlocked locations like Las Vegas, Phoenix and Atlanta. As these and other areas grow in population, they also grow in vitality. Cities once regarded as bastions of blandness now offer much more than strip malls and family-style chain restaurants. They offer sushi bars, dance and comedy clubs, and many other cultural amenities that, not so long ago, one could only expect to find in New York, Chicago or San Francisco.

As physical location decreases in importance, and the vitality gap shrinks, economic climate becomes ever more significant. Each month the Northeast and Midwest lose about 30,000 people, and these folks head toward locations like Atlanta, Las Vegas, and Phoenix where jobs are plentiful and housing is affordable.[107] Even college-educated people, those that state and local leaders are so anxious to woo, are increasingly likely to head to cities in the South and West and away from places like New York and Chicago. Between 1995 and 2000, New York and Chicago lost a combined 150,000 college graduates, nearly the same amount Atlanta and Phoenix gained.[108] In other words, the process of brain drain and brain gain is not solely an international phenomenon.

As Southern and Sun Belt states gain ground, some governments in more established locations have taken note, and taken action. Apart from vowing to support business-friendly policies, California Gov. Arnold Schwarzenegger has launched a high-profile campaign to lure businesses back to the Golden State. The campaign has included erecting billboards in states like Arizona and Nevada touting the California's renewed commitment to entrepreneurship. In response, Nevada recently created billboards that tout its strengths, and planted them in California. Over an image of a beat up worker with at black eye one billboard reads, "Will your business be terminated? Nevada to the rescue." Nevada advertises the fact that it has no corporate income tax, lower workers' compensation costs and more affordable real estate.[109]

Likewise, plenty of intrastate competition occurs among local governments. Southern California recently witnessed government competition in action when Yahoo subsidiary, Overture Services Inc., turned away from high-tax Los Angeles and decided to headquarter its 1000 employees in lower-tax Burbank. Overture's decision represents the kind of cost-benefit analysis that prompts countless other companies to relocate to other cities or states. The experience has also spurred local leaders to consider lowering taxes to make Los Angeles more appealing to business.[110]

Whether it is inter- or intrastate, domestic outsourcing forces governments to improve their products or suffer the consequences. Too often, though massive currents of jobs flow across American soil, lawmakers have decided to focus most of their efforts on the trickle of jobs that go overseas. How will this political decision affect our economy and the prospects of jobseekers?

Part 5

What Would Anti-Outsourcing Legislation Accomplish?

Tagging the wrong man with a crime is bad policy on two counts: It punishes the wrong person, and it allows the real culprit to run free. The debate over offshore outsourcing suffers in much the same way. Offshore outsourcing absorbs much negative publicity, but actually does more good than harm. Outforcing, on the other hand, is not the source of national outrage even though it makes more mischief.

Sadly, most of the proposals designed to address the issue of job loss still have the issue backwards. They would punish outsourcing, and let the real culprit, outforcing, run free.

State and Federal Anti-Outsourcing Legislation

In recent years, state and federal legislators have proposed over 200 pieces of anti-outsourcing legislation. Since most are still under consideration, we are now entering a crucial period, one that will likely determine the direction of American policy for many years to come.

Governors in Alaska, Massachusetts, Michigan, Minnesota, New Jersey, and North Carolina have issued executive orders designed to restrict outsourcing, and recently six states passed laws designed to discourage the practice.[111]

Table 12: State Level Anti-Outsourcing Laws

State	Effect of law
Alabama	Encourages state and local entities to use in-state services. Does not restrict or place mandates on procurement decisions.
Colorado	State agencies can contract for personal services performed outside the United States if it is clearly demonstrated that there will be no reduction in the quality of services and contracts contain confidentiality and right to privacy safeguards.
Indiana	Preferences between 1 and 5 percent for Indiana companies in the awarding of state contracts.
North Carolina	Preference for in-state or U.S. products and services within bounds of federal law provided that there is no loss of price or quality.
Tennessee	Preference for U.S. contractors in state contracts for the provision of data entry and/or call center services.
Missouri	Preference to in-state providers for state contracts.

Source: National Foundation for American Policy

In 2004, some 40 states considered various anti-outsourcing bills. Nearly all would do one of the following:

- Ban foreign or out-of-state bidders from competing for state contracts.
- Give preferences to U.S. or in-state contractors competing for state projects.
- Impose restrictions on certain fields, such as call centers.

Several pieces of federal legislation would mirror state-level proposals by placing restrictions on government contracting, but federal legislation would have more impact on private-sector outsourcing. Certain bills would, for example:

- Alter the tax code in an attempt to discourage outsourcing.
- Place restrictions on those seeking foreign visas.

The Genuine American Flag Act would even ban the importation of American flags. But even with all the political angst over outsourcing, there are many reasons why anti-outsourcing legislation would do much more harm that good.

1. Since offshore outsourcing is difficult to define, laws that target it would invite unintended consequences.

The kind of outsourcing that makes headlines occurs when an American company lays off American workers and sends those jobs overseas. But what if a certain job performed overseas was never performed in the United States in the first place? Is this offshore outsourcing?

Yesterday's automobile industry controversies about buying American versus buying foreign have been irretrievably complicated by our evolving economy. Today "foreign" cars are often built on American soil, by American workers. Half of all Toyotas and three-quarters of all Hondas sold in America are built in America, and sometimes "foreign" cars are more American than domestic models. The 2001 Ford Escort is 60 percent domestic content, while the Honda Civic coup is 75 percent domestic.[112]

Today's outsourcing debate centers not on constructing something that weighs thousands of pounds, but on providing a service, that is, something that involves transfers of virtually weightless information. This means that the lines between foreign and domestic will blur even more.

Companies report that their future outsourcing partners will likely combine both on and offshoring elements.[113] Imagine the case of a software company that outsources some functions to a U.S.-based partner. That partner may have offices in India and in the United States. If the partner offshores some functions, and tends to others on American soil, is that the sort of activity we would want to stop? A Missouri bill would ban certain kinds of state contracts in which "any part" of the contract is performed outside the United States. Apparently the ban would still apply even if 99 percent of the contract were handled across the street from the state legislature.

Technology's onward march will make today's definitions even less useful. Certain tasks may be passed back and forth from different foreign and domestic locations, much as U.S. companies collaborate with colleagues in different cities or states.

Most of the controversy over outsourcing stems from American jobs going to foreign nations, and yet many statehouses have already redefined the issue. Many anti-outsourcing bills make little distinction between foreign nations and other states. By, for example, proposing special preferences for in-state contractors, bills place other American bidders at a disadvantage. And if state governments find it appropriate to grant special preferences to in-state bidders, should local governments pass laws that give preference to bidders located in the same county or city? Such laws can quickly slip toward homegrown turf battles that have nothing to do with foreign competition.

Companies are well aware of the kind of fervor outsourcing stirs. Many have a standing “no comment” policy toward journalists reporting on the subject, and some business leaders have proposed ditching the term “outsourcing” altogether.[114] This reticence to deal with outsourcing will add to the enforcement headaches anti-outsourcing legislation would experience.

Obviously laws are best that are clear and focused on measurable impacts. A law that cannot even clearly define what it regulates is a law that is bound to be ineffective and will likely create unpleasant unintended consequences.

2. Anti-outsourcing legislation would make government more burdensome for taxpayers.

Most of the legislation designed to directly curtail offshore outsourcing is aimed at government-sector procurement. Often legislation seeks to give preference to contractors who hire in-state or at least within U.S. borders. By restricting the pool of potential bidders, such legislation restricts competition. The more government agencies turn their backs on the cost-containing potential of competition, the more government services grow more expensive than necessary. A government sector that chooses unnecessarily high costs passes that burden onto the private sector, and each extra burden makes private-sector expansion less likely, which results in fewer jobs. As goods and services become more expensive, the cost of living rises, decreasing spending power. Thus, anti-outsourcing legislation harms the American taxpayer from both sides: earning and spending.

It pays to recall the point of government procurement and outsourcing policy. It is not a jobs program. If it were, it would make the most sense for the government to produce all its own goods and services. Since government production typically requires more personnel than private production of similar goods or services, government production would be the way to create the most jobs. But procurement and outsourcing policy is not about creating jobs. It is about focusing government on those things it must do, that the private sector does not, and getting the most effective and efficient goods and services for the taxpayers in the process.

A recent Reason Foundation analysis found that the state of California could save taxpayers $2.4 billion by introducing competition into government procurement.[115] Competition typically yields cost savings of 30 percent, no matter if the service stays in-house or goes to the private sector. Without competition, agencies often overlook opportunities for cost savings.

The Power of Competition

In 2002, the Office of Management and Budget broke with tradition and decided to see if private printers could beat the Government Printing Office's deal for printing the 2004 federal budget. The result—the GPO cut its price 23 percent ($108,370) and kept the work. That is $100,000 a year that GPO could have saved taxpayers, any time it chose, but it never chose to do so until it faced competition.[116]

Some anti-outsourcing bills include provisions that allow government agencies to pursue offshore contracts only if the expected cost savings exceed a certain percentage threshold, say 10 percent.[117] Here legislators may argue that we need not choose between efficient government and protecting American jobs. Yet often the benefits of outsourcing come from cumulative and system-wide savings. For example, if one agency passes up one outsourcing opportunity because it would yield only a 9 percent savings, that decision alone probably would not impose significant extra costs. But a 9 percent cost savings here coupled with an 8 percent savings there, multiplied by many contracts, can lead to significant gains.

Some bills do not specify a certain percentage threshold, but offer unclear guidelines for awarding preferences, which invites regulatory confusion. For example, a California bill would give preference to in-state workers "to the maximum extent feasible."

In cases where governments have decided to forego savings and bring offshored jobs back to America, it is easy to overlook the actual magnitude of the extra expense. If, for example, foregoing outsourcing costs $100,000 per job retained, that is not a one-time extra expense. Taxpayers must absorb that extra expense year after year, so that after 10 years that single position could cost $1 million.

3. Anti-outsourcing legislation could push jobs to different states.

State legislators are the most prolific in proposing anti-outsourcing bills, and yet such legislation could end up pushing jobs out of state. If only contractors that do not engage in offshoring are eligible to bid on state contracts, states with highly developed technology industries may actually put local bidders at a disadvantage.[118] For example, it would be difficult to find a technology company in the San Francisco Bay area that does not practice offshore outsourcing.[119] The more local contractors that are disqualified from the bidding process, the more likely it is that contracts will go to out-of-state providers.

4. Anti-outsourcing legislation could prompt retaliation from other nations, resulting in the loss of American jobs.

Legislation that restricts outsourcing may violate certain international trade agreements (e.g. NAFTA and the Government Procurement Agreement) that the United States has signed. If the dispute resolution bodies that monitor compliance of such agreements determine U.S. law to be in violation, other nations may retaliate by slapping restrictions on their companies' (or governments') ability to contract with American companies.[120] In this way, anti-outsourcing legislation sets the first stone in a flurry of wall-building that only stymies trade in goods and services, and therefore the creation of American jobs.

If foreign nations erect more barriers to trade, U.S. companies can expect to lose business and may be forced to fire employees. Other nations may also make it more difficult for their companies to establish offices on U.S. soil, thus compromising the job security of millions of Americans who have jobs because of insourcing. Even if anti-outsourcing legislation does not explicitly violate international trade agreements, its passage may expose foreign leaders to intensified pressure to retaliate against U.S. businesses.

The Commerce Department estimates that 5,000 people are employed for each $1 billion in exports. U.S. high-tech exports stand at $171 billion and American technology companies receive 60 percent of their revenues from outside the United States. It quickly becomes clear that retaliation would put many jobs at risk.[121]

5. Immigration restrictions could slow job growth.

Our aging population means that a great many Americans will soon reach retirement age. By 2015 the United States will need an additional 16 million workers simply to maintain current productivity levels.[122] U.S. companies will need more highly skilled labor in the future, and immigration is one way to help them get it.

Foreigners have long found it easier to start businesses in America than in their homelands, and their arrivals have been good news for American jobseekers. Yet the benefits of "brain gain" could be compromised if Congress moves to restrict the flow of talented foreigners into the United States. Post 9/11 measures have already hampered companies' ability to hire and transfer foreign workers, as background checks now take many months to complete.[123]

Often foreigners create American jobs that would not have existed otherwise. But even when a foreigner competes with an American for an existing job, the foreign worker will only get the job if he or she is the best candidate. And even if the foreigner does get the job, it could very well mean a total increase in job opportunities for Americans. Each time a company boosts its productivity, it strengthens its position in the global market. A stronger position means it is less likely to fall into bankruptcy and more likely to expand and hire more employees.

Innovation creates jobs, but companies will innovate less and create fewer jobs if immigration policy is rigid. A trade policy that allows companies to move goods across borders helps support innovation, but companies need a similar kind of flexibility with regard to human capital. If we want more of the key innovations of the future to flourish on American soil we should ensure that immigration laws don't stymie brain gain.

6. Anti-outsourcing laws are not necessary to protect privacy or boost security.

Sometimes legislators object to outsourcing on privacy grounds. Often government agencies control personal information about citizens, and when services are outsourced keeping such information confidential must be a priority, whether the contractor is on American soil or overseas.

Privacy concerns are not new, nor are outsourcing agreements that involve sharing information. From general services to medical transcription, contractors have developed means of protecting privacy and pleasing customers.

The Progressive Policy Institute observes:

> *[T]o the extent that these proposed [anti-offshore outsourcing] laws are motivated by the desire to protect citizens' privacy, they may be solutions in search of problems. Privacy regulations that cover how U.S. companies handle their customers' personal information will continue to apply no matter where those companies, their subsidiaries, or contractors process data.*[124]

Security concerns cause some to object to government offshoring. But restrictions on offshoring won't make data more secure than current regulations provide, and in some cases might compromise security improvements. Roughly two dozen airports are considering using private contractors for security screening. But under current law only companies that are U.S.-based can compete to provide airport security. These companies must also be headquartered in the United States, making even U.S.-based subsidiaries of foreign companies ineligible.

This provision means that, for example, Wackenhut would be restricted from providing security, since it is now owned by the Dutch company Group 4. Group 4 is a large, well-respected company that provides security at many airports in Europe. By not even considering companies like this we could be passing up some of the most experienced contractors available. After all, many European airports have been on heightened terror watches since long before 9/11. No doubt they have accumulated knowledge that would be valuable to our own anti-terror efforts.

We already trust foreign pilots to fly us across the world, and we trust foreign manufactures to build those planes. Why would we then balk at foreign-owned security companies? If we want to have the best protection against terrorism, we have to put the best possible people in the right places. Moreover, the regulations that govern these employees, and the oversight and accountability mechanisms that ensure good performance still remain in the hands of the U.S. government.

Certainly the evolution of outsourcing into an international market may require changes that allow U.S. law to integrate with international laws. Legislators should address these relatively small changes and allow governments to make the most of outsourcing's efficiency gains.

7. Trying to curtail outsourcing likely would be futile and counterproductive.

Perhaps most significantly, the current litany of anti-outsourcing legislation is not likely to stop or significantly restrict the practice. The economic benefits of outsourcing are strong, and that means that companies are likely to continue to turn to outsourcing even with newly emerging political roadblocks.

According to one survey, nearly 70 percent of companies that practice outsourcing say they are satisfied or very satisfied with the experience.[125] Moreover, satisfaction rates increase the longer companies practice outsourcing. Each company goes through a learning process in which it discovers which functions are well-suited for outsourcing and which are not. As institutional knowledge grows, the outsourcing process will become more fine-tuned, and we can expect satisfaction rates to increase even more.

Companies report typical cost savings from outsourcing (both on and offshore) of between 10 and 50 percent. And far from sacrificing quality for lower cost, most also report that outsourcing has improved quality.

The only way to stop outsourcing would be for politicians to embark on a tenacious campaign of harsh legislation. And then, if such a campaign were "successful," so that companies were incapable of outsourcing, they would simply respond to such drastic measures with drastic measures of their own, such as moving their operations to a different, more hospitable state or nation. Even if companies do not relocate, most jobs will not be saved but will be absorbed by new technology. Increasingly, the choice is not between sending jobs overseas or keeping them at home, it is between sending jobs overseas or sending them to a computer.

Anti-outsourcing legislation distracts attention from more productive pursuits: namely, combating the real job market boogeyman—outforcing. Such legislation is more likely to simply hamper the process of innovation that is our nation's best hope for continued job creation. Lawmakers must reinvigorate their efforts to defend the innovative economy.

Part 6

A Plan of Action

After we realize that an innovative economy should be our goal and that anti-outsourcing proposals would compromise this goal, we can now settle upon a specific course of positive action. Some action is strategic in nature requiring a change in mindset, while other action requires changes in policy.

A. Strategic Recommendations

1. Focus on the big picture.

Job creation is a messy process in which jobs are constantly created and destroyed. Outsourcing is only one of many factors that affect the churn of the job market. Although outsourcing receives much media attention it is quite clear that other factors, such as technological innovation and interstate trade, have more effect on the ebb and flow of jobs.

Moreover, job creation does not adhere to the schedule of elections. Considering the big picture also means considering the big picture time frame. Job growth may dip for a period of months, perhaps even years, but as long as entrepreneurs are free to innovate, in the long run, job gains will dwarf dips.

2. Accept a new definition of job security.

As the market evolves, so must the worker's mindset. Job security no longer means fighting to keep the same job for 30 years; it means keeping ourselves marketable. Just as the market searches for ways to do things better, so will tomorrow's workers—by gaining new knowledge and skills—seek to better themselves with regular, personal improvement. Since changing jobs more often has become more common, workers must also muster the self-control necessary to live below their means and save for a rainy day.

B. Policy Recommendations

1. Resist anti-outsourcing legislation.

Efficiency improvements cause pain, but ultimately they help create more jobs than they destroy. Outsourcing is no exception. Outsourcing allows firms to operate more efficiently, save money and invest in job expansion.

Of course, policymakers feel great pressure to "do something" about outsourcing and the following policy recommendations outline positive steps that can be taken to quell outsourcing fears and reduce outforcing. Governments at every level must ask what their jurisdiction offers that entrepreneurs and other talented people find attractive. These strengths should be bolstered. Next, leaders must ask what makes entrepreneurs and other talented people hesitant to stay in or come to their jurisdiction. These weaknesses should be improved.

2. Encourage workers and companies to prepare for employment transition.

During speaking engagements one of this study's authors often conducts informal experiments that expose the gap between Americans' job security anxieties and the actions taken to address them. Dr. Moore asks audience members how many are currently employed at the job they expect to hold for the rest of their careers. Few, if any, hands shoot up. Next Dr. More asks how many are saving money for the employment transitions they just admitted are coming. Again, few, if any, hands shoot up.

Americans feel anxious about job transitions, they know they are coming, and yet few do anything to prepare for the inevitable. Lawmakers can craft public policy that makes it easier for Americans to weather the periods between jobs, but those policies will do little good if Americans themselves do not accept the responsibility to prepare for transition.

Dr. Moore's experiment reveals another under-appreciated aspect of the job security debate—job transitions affect all of us, not just those employed in occupations vulnerable to offshoring. Yet lawmakers and researchers have focused much energy on tending to those affected by offshoring. Some, for example, suggest that wage insurance be extended to workers who lose their jobs to offshoring. Certainly the worker who loses his job to offshoring faces much adversity, but so does the film developer whose job disappears because of consumers' shift to digital cameras. What about other victims of improving technology, or those who lose their jobs to domestic outsourcing, to outforcing, or to countless other market upheavals, which, while they may receive less attention, are no less traumatic? Should we extend special protections to victims of outsourcing simply because their plight is particularly well-publicized?

"Yes," respond many elected officials who wish to remain in office. And it would be, of course, naïve to neglect the huge role perception plays in politics. When constituents clamor for something to be done about offshoring, few officeholders care to suggest that their fears are perhaps not deserving of special attention. Thankfully some proposals can address the specifics of offshoring and still remain relevant to other workers whose transitions are prompted by different causes.

Policy could encourage companies to purchase insurance policies that would help outsourced workers during their transition time. Since the perceived threat of getting outsourced to the unemployment line is much greater than the actual threat posed by outsourcing, such insurance programs would be relatively cheap to implement, only about five cents per dollar saved from outsourcing, by one estimate. IBM has recently created a retraining fund for outsourcing-wary employees. [126]

Tax breaks could encourage companies to provide transition assistance. Such assistance could take the form of a specialized IRA, into which employees pay, and are allowed to withdraw the funds tax-free if the withdrawal occurs during a period of employment transition.

Most anti-outsourcing legislation addresses government procurement, and recall that some states have undone offshoring contracts at the cost of over $100,000 per government job brought back to the United States (and since that is an annual cost, the actual cumulative cost is much greater). In this case, it would be better to offer retraining and severance packages to affected workers than to pass up savings offered by outsourcing. The benefits passed on to affected workers could be based on a certain percentage of the savings brought about through offshoring.

Higher education also has an important role to play. More universities, colleges, and community colleges should prepare students for the new challenges they face. Moreover, education cannot be thought of as something that ends in our early 20s. For workers to thrive in today's market, they must regard education as an ongoing process.

3. Make benefits portable.

In previous generations it was typical for a worker to spend 20 or 30 years with the same company. Today's worker is much more likely to change jobs more often, and yet the way we receive many important benefits has not changed with the times.

Most Americans, for example, still receive medical benefits through their employers. Lost jobs also mean lost benefits. But workers don't lose their auto insurance when they lose their jobs, why should they lose their health insurance?

Americans assume that it is appropriate to get medical insurance through their employer, if for no other reason than that is the way it has worked for decades. Yet employer-provided coverage emerged not because it was the best way to keep our nation healthy, but because of political twists and turns that had nothing to do with the effectiveness of this arrangement:

> *During [World War II], employers competing for workers found a way around the government's wage controls by offering health insurance in lieu of higher pay. On October 26, 1943, the Internal Revenue Service further encouraged this practice by ruling that employees did not have to pay taxes on such benefits. In 1954 Congress codified the tax-exempt status of employer-provided health insurance.* [127]

Outdated policies have locked Americans into an inflexible vision of health care that does not suit today's mobile workforce. If health care were not tied to employers, employees could enjoy health coverage even when they were in between jobs. Doctor-patient communication would improve since patients would not have to switch doctors when they switch jobs. Better communication would lead to better care. Many aspects of employer-provided coverage also drive up the cost of health care, so transitioning away from this model would likely lower costs as well.

One way to transition away from our current model would be to make health insurance mandatory. Such an arrangement could mirror auto insurance in which law requires drivers to have insurance, but coverage is still provided by the private sector. Apart from being portable, such a model could mandate universal coverage, and still allow America to benefit from private-sector innovation.

Mandatory health insurance has the potential for widespread political support. Senate Majority Leader Bill Frist (R-Tenn) recently suggested that mandatory health insurance should be required for at least some Americans, and the New America Foundation, a liberal think tank, has even outlined how such a system might work.[128]

Mark Pauly, a health care economist at the University of Pennsylvania's Wharton business school, is optimistic about how mandatory coverage would reshape health care. "Mandated coverage would replace Medicaid and state Children's Health Insurance Programs because lower-income and unemployed people would receive a voucher to purchase private health insurance," he says.

No doubt, with a proposal as ambitious as this, the devil is in the details. A close examination of those details is beyond the scope of this study, but here the New America Foundation has already done much of the heavy lifting. The NAF plan addresses a wide range of issues and questions pertaining to mandatory insurance, including particularly difficult issues, such as how to pay for those who still do not obtain coverage.[129]

4. Improve math and science education.

If our nation's education system does not improve, employers will increasingly look to other nations for talented workers. Certainly, improving education is always an important task, and the globalization of the economy and the rise of outsourcing simply offer more reason to push for progress. American education struggles in many areas, but it is low student achievement specifically in math and science that prompts employers to fill tech job openings with foreign workers. Interestingly, America's students do not necessarily start out less proficient than the rest of the world.

America's young school children fare quite well when compared to their international counterparts; but the longer they stay in school the farther they fall behind other nations' students. Of course we cannot force our school children into liking math and science—nor should we try. The trick is nurturing the initial interest that, for whatever reason, gets suffocated over time.

Since our children are falling behind in math and science, policy should reward teachers that do the best job teaching these subjects. Merit and differential pay would help attract talented math and science teachers. One merit pay model, Teacher Advancement Program, has been adopted by districts in ten states. A recent study that compared TAP and non-TAP schools found that TAP schools outperformed the control group about 70 percent of the time.[130]

Our nation should also do a better job of taking advantage of a highly qualified pool of potential teachers. Policymakers should remove certification barriers that discourage retirees with math and science backgrounds from becoming teachers. School children would be most fortunate to receive biology lessons from a former cardiologist, and policy should accommodate such arrangements.

Since there is no one best way to teach all children, policy must allow for flexible and innovative teaching approaches. Various forms of school choice can offer parents and students more options, and thus increase the likelihood that students will be placed in an environment that meets their particular needs.

Even allowing for greater choice within the public school structure can help give students a greater chance of finding a stimulating teaching environment. Charter schools provide another way to offer more choice and competition within the public school structure. Yet in many areas various institutional barriers make it difficult to establish charter schools. State and local government restrictions also often discourage the construction of new private schools.[131] Lawmakers should remove, or at least relax, regulations that restrict the establishment of charter and private schools.

5. Reassert America's position as the land of opportunity.

Do we want companies to pay our government or our workers? While a company's location decision is based on many factors, regulatory policy matters. Companies are more likely to create jobs in areas that have lighter regulatory burdens.

National leaders should take a close look at how the United States compares to its trading partners on corporate tax rates and other key measures of international competitiveness. Many organizations compile indexes that rank nations on many different categories, from trade policy to debt burdens.[132] Where the United States stands among its trading partners should be in the forefront of our leaders' minds. The farther down the list our nation tumbles, the more difficult it will be to enjoy the job creation effects of entrepreneurship. Likewise, we can improve our position in the world by climbing those crucial lists and doing whatever necessary to remain near the top.

The United States has a huge advantage in that it has long been a leader in creating an environment that spurs innovation and entrepreneurship. Yet we cannot rely on our past momentum to carry us into the future. Two factors are at play: other nations' desire to benefit from economic liberalization and our own complacency. As noted earlier, the United States has, for the first time, slipped out of the list of the 10 freest economies.

As other nations liberalize their economies and break down barriers to trade, our nation must reassert itself as the land of opportunity.

6. Relax land use regulations.

Rigid anti-growth laws inflate the cost of real estate for businesses and families. A Reason Foundation study of planning laws in Oregon, Washington, and Florida found that statewide restrictions impose a "smart growth tax" that accounts for 26 percent of the increase in housing prices.[133]

Tight land use policies inflate the cost of housing, and, in order to attract and retain talented workers, companies must offer salaries that offset the higher cost of housing. The added expense often means that companies hire fewer people.[134]

Regulations are often a key contributor to declining housing affordability, and yet local governments often choose to respond with additional regulations that mandate affordable housing. Inclusionary zoning, in which developers must sell a certain number of units below market value, has been one popular approach. But recent studies have found that inclusionary zoning only exacerbates housing crises experienced in such places as Southern California and the Bay Area.[135]

Instead of imposing slow growth polices and then responding to their negative effects with affordability mandates, governments should simply allow for more housing supply to enter the market. Even building high-end real estate can ease housing prices for the middle class and first-time homebuyers. Affordable housing typically is not new housing, but older units that enter the affordable housing stock when the original owners trade up. When growth restrictions limit new housing, fewer middle-class homeowners can trade up and fewer would-be homeowners of more modest means can afford that first home.

7. Support telecommuting or "homesourcing."

Cost savings is one important reason companies turn to offshore outsourcing. Yet companies have discovered that drawbacks like cultural differences and language barriers can complicate the process. Such complications may, at least partly, offset other benefits.

Of course, companies have less reason to worry about cultural differences or language barriers when they hire American workers. Find a way to decrease costs and there would be even less reason for companies to go abroad. In some cases, telecommuting is that way.

From office space to heating costs, telecommuting reduces many of the costs associated with hiring workers. For example, traditional U.S. call centers cost about $31 dollars per employee hour, while home-based operations cost only $21.[136] Many employees enjoy the flexibility that telecommuting offers. They like the idea of avoiding a long commute and being able to spend more time with their families.

Thanks to constantly improving technology, more and more occupations are compatible with telecommuting. It is, therefore, no surprise that telecommuting has grown in recent decades. The Bureau of Labor Statistics estimates that our nation is home to nearly 20 million telecommuters, and yet telecommuting is still not as prevalent as one might expect.[137]

One of the barriers to even greater telecommuting growth is psychological. Managers often fear that, without close supervision, employees' productivity will suffer. Yet there is actually much evidence that suggests the contrary: telecommuters are more productive than their office-dwelling counterparts. For example, a survey of American Express tele-workers found that they produced 43 percent more business than office workers. And it's actually quite easy to understand why that is the case.

Employees enjoy the freedom and flexibly telecommuting offers, and satisfied workers are more likely to be more productive. Telecommuting also shifts how managers measure performance. There is now less emphasis on how long someone works, and more emphasis on results. Managers pay closer attention to the end product, and this increased attention often allows for increased productivity. Once more managers realize that telecommuting offers both lower costs and higher productivity, we can expect more of them to embrace the practice.

Lawmakers can help managers embrace telecommuting, for another significant barrier to telecommuting is political. Politicians tend to have very kind words for telecommuting. They rightly recognize its many benefits, from congestion relief to improved air quality, and yet public policy often hampers telecommuting. Barriers to telecommuting can be found at every level of government, from unfriendly federal tax laws to local zoning codes that restrict telecommuting and home-based businesses. Lawmakers should comb through and repeal or at least relax any law that makes it more difficult for Americans to enjoy telecommuting's benefits.

8. Outsource more government services.

Outsourcing (whether on or offshore) done right makes for a less expensive government, and creates an environment better suited to private-sector job growth. Only a wealthy society can purchase the services of software engineers, orthodontists and countless other jobs that have become commonplace in the modern economy. A wasteful government is an unnecessarily expensive government. Since taxpayers must bear the extra expense, it becomes more difficult for society to support private-sector services, and more difficult for the private sector to create jobs. Since governments are typically shielded from market consequences of wastefulness, such as bankruptcy, they must exert extra vigilance to guard against inefficiency.

Lawmakers may assume that government services can be run more efficiently even without the competitive pressures of outsourcing. Yet, without competition agencies tend to overlook potential cost savings. As noted earlier, the Government Printing Office lowered its costs only after exposure to competition. The GPO example illustrates another important point about government-sector outsourcing. It is the process of competition that matters most, not whether a particular service ends up in private or public-sector hands. This process lightens the cost of government and helps produce an environment friendly to private-sector job growth.

Part 7

Conclusion

Policymakers can choose to continue to target the wrong culprit by pushing anti-outsourcing legislation or they can pursue the real threat to jobs—outforcing. The future vigor of our labor market depends on our ability to learn from the past and realize that innovation stirs anxiety, but ultimately brings a better world.

Americans know this. Time and again they have turned threats into opportunities. The Internet is far more revolutionary than outsourcing, and most Americans have come to recognize it as a force for good. Though threatening when it emerged, the Internet has given us jobs that did not exist just a decade ago.

When they were in third grade, today's 30-something Web designers had no idea what they would be when they grew up. That is the way innovation has always worked, and that is how it will continue to work. We cannot predict exactly what will come next, but we can be quite confident that it will be better than what we have now. As long as we continue to side with innovation, who knows what kinds of wonderful jobs will be available to today’s third graders.

About the Authors

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Mr. Balaker edits *Privatization Watch*, which analyzes the latest developments in privatization, outsourcing, and government reform. *Privatization Watch* provides lawmakers nationwide with tools to improve their communities and has been described as "energizing," "subversive," and "highly relevant" by the Institute of Economic Affairs. Prior to joining Reason, Mr. Balaker spent five years with ABC Network News producing pieces on issues ranging from regulation and economic development to addiction, self-esteem, free speech, and the environment.

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Dr. Moore is co-author of *Curb Rights: A Foundation for Free Enterprise in Urban Transit*, published in 1997 by the Brookings Institution Press, as well as Reason Foundation policy studies on regulatory reform and privatization of prisons and utilities. His articles have appeared in many publications such as *The American Enterprise*, *The Independent Review, Economic Affairs*, and *Public Policy and Management*, *Consumer Affairs*, and *Regulation.* He has also published op/eds in newspapers nationwide including the *Los Angeles Times, Boston Globe, Houston Chronicle,* and the *Atlanta Journal and Constitution*.

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Endnotes

1 A September 2004 Zogby International poll found that 71 percent of Americans thought outsourcing hurt the economy, and 62 percent supported laws that penalize companies that use offshore outsourcing.

2 The National Foundation for American Policy, which tracks anti-outsourcing legislation, reports this trend.: NFAP.net

3 For more on this see: W. Michael Cox and Richard Alm, "A Better Way: Productivity and Reorganization in the American Economy," Federal Reserve Bank of Dallas, 2003 Annual Report.

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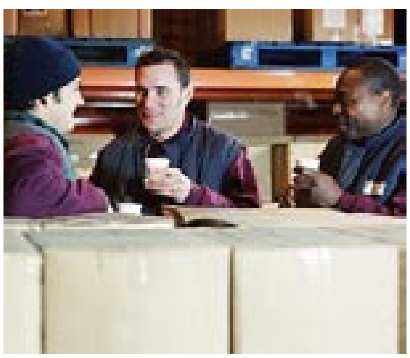

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