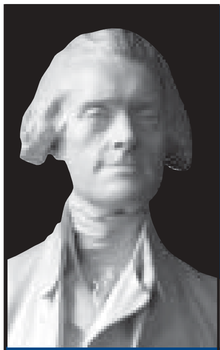

Jeffersonian Principles in Action

ALEC Issue Analysis

The Offshore Road to Serfdom

By Adrian Moore and Ted Balaker *April 2004*

Just about everyone is in a tizzy over "off shore outsourcing"—the latest efficiency-seeking practice that sends service jobs to India, China and other developing nations. CNN's Lou Dobbs rails against the "Outsourcing of America," and John Kerry hopes blaming "Benedict Arnold CEOs" will land him in the White House. Consultants who help companies arrange offshore outsourcing agreements predict it could affect up to 3.3 million jobs by 2015—take away the marketing hype, and it could still easily affect 2 million jobs.

The purveyors of panic are right about one thing—outsourcing is not a passing fancy. It is the latest stage in the continual evolution of our economy. And just like at every other stage in that evolution, the change will offer more benefit than pain.

But, just like at every other stage in that evolution, a lot of people don't want to change, and in their desire to keep the economy static they push a lot of bad policy ideas. The belief that we can stop or control the evolution of the economy is at the root of the famous "road to serfdom."

Before they leap to appease frightened voters, state legislators facing pressure to "do something" need to understand some fundamental realities about private and public sector outsourcing.

The Politics of Offshore Outsourcing

The offshore outsourcing debate simply places the politics of globalization and international trade in a white-collar setting. The new free-trade opponents are white-collar workers and executives who long believed that their education protected them from foreign competition.[1]

Workers grow anxious when faced with layoffs and job changes, and we should help them cope with the destructive side of market creation. But the objections to the evolution of the economy are like a broken record. Once we thought all you had to do was own some fertile land and work hard, and you could make a good living farming forever. Then we thought if you got a job working for one of the nation's industrial giants you effectively had a job for life. More recently, people believed that if you stuck it out through college and got your degree, you'd always have a job. None of those approaches proved to be a failsafe route to job security, and yet—even with the churn of the market—today's workers have enjoyed ever-improving standards of living. More than ever, job security is about personal improvement. What do you have to offer and how can you add value?

British Prime Minister Tony Blair recently told his nation's industry "What I can't do is shield you from the world. The economy out there will be decided by knowledge, skills and education, by value-added goods and services."

When White House chief economist Gregory Mankiew took a beating over his comment that offshore outsourcing is just international trade, most people overlooked that at least four top economic advisors from the Clinton administration publicly stated that Mankiew was right.[2]

But in politics, protectionism sells because it comforts people. Voters hope politicians can shield them from change. However protectionism cannot eliminate a market's growing pains, it only delays the pain, which makes it worse in the long run.

Economics of Offshore Outsourcing

The media buzzes with stories about American jobs going offshore. High-end estimates predict that—between now and 2015—3.3 million U.S. information technology jobs will move offshore.

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But that prediction ignores that the information technology industry continues to grow and now job creation outpaces job loss.

Everyone knows that in the last economic downturn the nation lost 2.3 million jobs. What gets overlooked is that about two-thirds of those jobs—about 1.5 million—were "tech bubble" jobs, not permanent jobs in the economy, and the remaining 800,000 jobs are what we would expect to shed with normal cyclical fluctuations in the economy.[3]

But even as the market churn cuts some jobs, it adds much more. At the end of World War II, there were about 138 million Americans. Today, 138 million Americans have jobs.[4] From 1980 to 2002 the U.S. population grew by 23.9 percent. Meanwhile, the number of people with jobs grew 37.4 percent. Clearly, the best jobs program is an efficient market.

Along with job growth have come amazing productivity gains—each American worker is producing vastly more than he once did, and much of that productivity is thanks to trade. Offshoring the production of computer components and other kinds of manufacturing led to much lower technology prices. Firms then reinvested in productivity growth, giving our nation a $230 billion boost in GDP that would not have occurred otherwise.[5]

Even that dramatic increase in wealth is dwarfed by large-scale trade expansions like NAFTA and GATT. The growth in imports and the corresponding improvement in productivity pushed prices of goods down, improving the purchasing power of everyone. With more of its basic needs met, a wealthier society can afford to support new industries that offer employees better jobs.

Because we produce more "things" than ever before, the decline in employment is, in effect, a good thing, because it means that manufacturing employers can afford to pay high wages to manufacturing workers while still competing with low-wage workers in places like Mexico and China. In 2002 all U.S. workers produced $71,600 in output each (in 1999 dollars). The next highest country was Belgium, where each worker produced $64,100. Japanese workers — renowned for their productivity — produced just $51,600.[6]

Offshore Outsourcing Creates Jobs at Home

When companies save money by sending rote work overseas, they invest more to create new jobs at home. An analysis of labor data by the Institute for International Economics show that while more than 70,000 computer programmers have lost their jobs since 1999, more than 115,000 higher paid computer software engineers have been hired since 1999.[7] In fact, they find, most of the jobs that will be lost offshore pay less than the U.S. average wage and are likely to be eliminated through technology whether outsourced offshore or not. The U.S. IT industry created 148,000 net new jobs in the last quarter of 2002, even with a slower economy and with the offshore movement in full swing. The story is the same for the service sector as a whole. While recently it has lost 10 million jobs per year, it has added jobs at an annual rate of 12 million.

What is often overlooked is that more jobs are insourced than outsourced. Data from the Commerce Department show that in 2003 we exported more than $50 billion more in services that we imported.[8] As one economist put it, "the benefit of importing services is the same benefit that comes from importing goods."[9] Improved productivity lowers the price of goods for U.S. consumers and boosts wages and profitability, which in turn feeds job growth.

Think about agriculture for a moment. Would we be better off if we had saved all the farm jobs that existed a century ago? How would things look if 70 percent of all American workers were still tilling the soil instead of the 3 percent who actually are?

Our best example to understand all of this is what is happening in manufacturing.[10] Manufacturing jobs fell 16% in the last 3 years. But keep in mind that during the last decade manufacturing employment fell by far more in Britain, Japan, and Germany. Only Canada and Italy improved—but those economies lagged U.S. job growth in other sectors.

But at the same time, manufacturing is healthy. Industrial production is up 5 percent, and real goods production as a share of real (inflation-adjusted) GDP is close to its all-time high at nearly 40 percent. Far more than the "good old days" of our industrial dominance.

So what gets outsourced overseas are jobs that have become routine, commodified in many ways, and where US worker productivity is no longer beating out foreign workers—where they don't have an edge in skill or knowledge or relationships.

Meanwhile, 2/3s of the economic benefit from offshore outsourcing accrues in the US in the form of lower prices, expanding overseas markets for U.S. products, and improved profits that are reinvested in new sources of U.S. production and jobs.

Where the Change is Really Coming From

The real source of change in American jobs comes from machines. After all, those soulless slaves to efficiency have stolen more American jobs than any foreigner. Hollywood visionaries use films like *The Terminator* and *The Matrix* to warn us of the coming war against the machines. Well, the war is here. Actually, it's been here for a long time.

The printing press swallowed human scriveners and the photocopier and personal computer destroyed countless office jobs. Just weeks ago a Kentucky city mourned when a machine replaced its last human elevator operator,[11] and even the recently resolved Southern California grocery strike may turn out to be another victory for machines as some stores begin phasing in automated checkout machines, which means human checkers work alongside machines that may eventually take their jobs. An analysis of Bureau of Labor Statistics data notes that—even without outsourcing—technology would have eliminated most of the jobs now going overseas.

Of course, cursing machines misses the point because it tells only half of the story. Sometimes an industry disappears or shrinks to a nub of its former self, and yet new life continues to sprout. It would be tough to find many scriveners today, but the printing press and the PC haven't destroyed office jobs. In fact, there are 19.5 million of them.

As the market evolves, we don't just exchange fewer jobs for more, we also trade up for better jobs. Since today's office mates squabble over a couple of clicks on the thermometer, it's a good thing few of them will have to find out how they'd survive in, say, a mineshaft. During the past 50 years we've lost over a quarter-million mining jobs, but we've gained 78 million service sector jobs. Today, 19 times as many Americans work in finance as in mining; 22 times more work in hospitality, and 54 times more work in health and education.

It's often difficult to track job growth by a particular occupation, because many of today's jobs were created recently. Today's jobseeker has more choices than ever, which means that we are more likely get paid to do something we enjoy. Americans hold millions of jobs that did not exist a century ago. For example, our nation is home to 758,000 software engineers, 299,000 fitness workers and 128,000 aircraft mechanics. And many of the old-style jobs—far from being outsourced into oblivion—are more plentiful than ever. Our nation has 6.5 million teachers, 718,000 hairdressers, 281,000 chefs and 112,000 biologists.[12] The chance for work to aid rather than hinder our quest for fulfillment is a truly historic development. How many miners stuck deep within the earth would rather have been video editors, web designers or car customizers?

Offshore Outsourcing by Governments

In the midst of all this, small in scale but important to many people, is the outsourcing of government services, some of which has gone offshore. In 40 states and DC people collecting food stamps use foreign help desks. Programmers in India are helping revamp South Carolina's unemployment tax system. And most famous so far is the case of New Jersey's unemployment insurance assistance center where work was outsourced and went offshore.

The NJ example is instructive. The hullabaloo over having about 10 jobs go offshore meant substantially higher costs for taxpayers—it cost the state about $100,000 per year per job they brought back to the U.S. The state could have spent $50,000 on each worker who lost their job for training, education, employment support, etc. and still come out ahead with large savings in subsequent years.

Remember mutual gains from trade. The state of New Jersey could have benefited from buying lower cost services and less spending or more funds for higher priorities. Writ large, such decisions keep taxes lower which stimulates business activity, creating more tax revenue for the state. Productivity growth in New Jersey is enhanced, lifting the standard of living. Everyone in the state of New Jersey is marginally better off in the long run.

This is another version of the long running debate over privatization, of which outsourcing is but a type. Governments at all levels in the U.S. outsource close to $500 billion in contracts. The New Jersey story tells us why—outsourcing can dramatically reduce costs. And not only does outsourcing save money but quality is high as well—over 90 percent of services that are outsourced stay outsourced even when governments have the chance to bring them back in-house.

That does not stop people from resisting privatization and outsourcing and no red herring is overlooked. The issue of privacy protection in offshore outsourcing is a good example. The idea is that the government possesses personal information about many citizens, and when many kinds of services are outsourced, from call centers to data processing, some of that information is handled by contractors, some of whom might be overseas.

Yes, the handling of such information must be controlled to protect people's privacy. But why is offshore information handling more of a risk to your privacy? Is a young woman in India who, in answering your help call sees financial, medical, or other private information about you, have more reason and more opportunity to steal and abuse that information than a contractor in the U.S? No, if fact she has much less incentive and much less opportunity to violate your privacy.

And her boss has every incentive to protect your privacy as well. His company is riding the most exciting wave to hit his economy in years. The best way to get knocked off the wave is to do something that drives the customers away, like violating privacy agreements. When Dell pulled its help center business back to the U.S. due to customer complaints the reaction by Indian firms was quick, with more emphasis placed on improving English language skills and guaranteeing customer satisfaction.

Moreover, this is not a new problem. Since the first time information sharing was included in an outsourcing agreement, we have worried about and sought to protect privacy. From outsourcing of general services[13] to medical transcription,[14] to IT,[15] outsourcing practitioners have developed means of protecting privacy in outsourcing arrangements.

Of course the evolution of outsourcing into a more international market may require some changes in law in the U.S. to integrate with existing international law that protects against privacy invasion and other harms.

But legislators should take care not to quash the benefits of outsourcing while addressing small changes that may be necessary. And trying to create bright distinctions in a rapidly changing market will only invite outcomes where the taxpayer loses.

The technology industry is too dynamic and complex for legislators to answer the admittedly legitimate concerns about the downside risks and consequences of using offshore resources. Right now companies headquartered in the U.S. are acquiring offshore companies, and it will soon be impossible to determine if something is "offshore" simply by checking the name of the company on an employee's badge.[16]

Some Reality in Offshore Outsourcing

Politicians who pump up public fears hope that voters will see offshore outsourcing as a newly-invented threat to jobs. Of course, outsourcing is not a new creation, rather it's merely the latest evolution of a process that's been around for a long time—trade. Trade has given people ever-rising standards of living, as well as more and better jobs. Like trade in general, outsourcing creates more than it destroys.

Likewise, when governments outsource services overseas, we have much more to gain than to lose. We must remember that government exists not to create jobs, but to provide services. Government outsourcing—like trade—seeks to do things better and more efficiently. When a society pays less for government services, it can afford to pay more for private services. Only a wealthy nation can purchase the services of web designers, software engineers and orthodontists. A fatter government slows the efficiency seeking process that employs an ever-growing workforce. If we instead prefer to see government as a jobs program, there will always be plenty of ways to increase jobs. We could expand upon the New Jersey model. After bringing government jobs back to American soil we could create more jobs by, say, eliminating computers. For each computer destroyed we could employ dozens of human bookkeepers. Of course, each concession to inefficiency makes our society less competitive and makes future job growth—in areas that actually improve living standards—less likely.

Even though public and private sector offshoring will continue to create more than they destroy, there is always room for improvement. We should take privacy and national security concerns seriously, and we should have compassion for those who are outsourced to the unemployment line. We need to find policies that help workers deal with the churn, and help them find ways to work where they are more productive than their competition.

And an efficient economy (or an efficient government) can offer hope even to its victims—for victimhood itself is a temporary state. According to the Bureau of Labor Statistics, most of the unemployed find new jobs within three months, and the efficiency-seeking forces that fire a worker are the same forces that will ultimately rehire him. Moreover, 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.

While we should have compassion for the victims we can see, we should also have compassion for the victim we cannot see. Choosing inefficiency over outsourcing means slowing the most robust jobs creating machine the world has ever known. It means less money will be reinvested, fewer companies will expand and—ultimately—higher unemployment.

However, since unions don't form to protect the jobs of the future and since politicians bend only to the political pressure they can see, we can always expect a new—and similarly shortsighted—political challenge to markets.

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