Outsourcing jobs: U.S. dilemma
by Bruce Stokes

Callers checking their credit card balance with American Express are likely to be greeted these days by the crisp, Anglo-Indian accent of an operator answering queries from a call center somewhere on the Indian subcontinent. Almost nine out of ten people applying for an online loan from the lending company E-Loan are also likely to have their applications processed in India.

Welcome to the new global service economy, where the latest information technology allows a trained, cheap foreign labor force to provide American consumers with financial information, data processing and airline services at any hour of the day or night. Outsourcing this work overseas — "offshoring" — saves the U.S. consumer and the American economy a ton of money. But the savings come at a price: the loss of white-collar jobs that were supposed to provide future employment for the sons and daughters of Americans who lost their jobs in the shrinking manufacturing sector.

One's opinion on whether the movement of U.S. jobs offshore is good for America depends predictably on where one sits. Academic economists and venture capitalists, business and labor, Democrats and Republicans, and average working Americans all have their own views. One's stance on the offshoring or outsourcing question depends on how one answers three sets of questions: one historical, one theoretical and one practical.

First, is this outsourcing merely the latest phase in the evolution of the modern global economy — disruptive for those involved, but ultimately beneficial for the greatest number of people? "Outsourcing is just a new way of doing international trade," said Gregory Mankiw, chairman of President George W. Bush's Council of Economic Advisers, on February 9, 2004. "More things are tradable than were tradable in the past, and that's a good thing." Democrats and some Republicans disagreed, arguing that in an American economy already beset by slow job growth, wage stagnation and rising long-term unemployment even among college-educated workers...

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workers, sending jobs abroad was sheer folly.

Second, does sending jobs overseas reaffirm the economic principle of comparative advantage—which holds that everyone gains if every country specializes in what it does best? Or do 21st-century economic realities—the mobility of capital, the use of the internet to move labor around the world, and the availability of tens of millions of well-educated, English-speaking, highly productive, low-paid Indians—make 18th-century economic theory obsolete? In a recent white paper for the Democratic Policy Committee, University of Maryland professor Herman Daly and former Senate staff aide James Socas succinctly summed up this view: Because of either ideology or old thinking, "history is often the story of nations and leaders unable to account for what is new and different."

The third set of questions is practical. Is the projected level of outsourcing tolerable for the U.S. economy, or is it just the tip of the iceberg? Certainly some economists think so. "This is going to be much, much bigger than we ever imagined," predicted Martin Kenney, a professor at the University of California, Davis, and a coauthor with Rafiq Dossani, a senior research scholar at Stanford University, of the study "Went for Cost, Stayed for Quality? Moving the Back Office to India."

To date, the response of Washington policymakers to these questions tends to echo the opinions of their ideological allies and professional supporters. Many economists, for instance, dismiss concerns, stressing instead the broad benefits of offshoring. The skeptics of offshoring, such as labor unions, manufacturers, and an increasing number of one-time supporters, tend to come out with knee-jerk solutions. According to Stephen S. Cohen, codirector of the Berkeley Roundtable on the International Economy at the University of California, Berkeley, an interdisciplinary research group that works on issues of technology and the international economy, "the bleeding-heart liberals say, 'Throw in more money for those who lose out.' And the Luddites say, 'Stop it.' But they don't know how to do that."

Any action in Washington to address offshore outsourcing depends on the health of the U.S. economy in 2005.

THE INDIA CHALLENGE

The Chrysalis Capital office, in the corner of the first floor of the posh Oberoi hotel complex, overlooks a verdant parkland nestled in the inner suburbs. The suite’s décor is formal—more European than American—without being stuffy. It suggests that those who work in these rooms, investing other people’s money, are more worried about performance than appearance. Only the Indian art on the walls hints that this venture capital firm operates in Mumbai and Chennai, not Palo Alto.

Ashish Dhawan, one of Chrysalis’s founders, is a compact, impeccably turned-out man, whose ambitious vision and mastery of detail exudes a salesman’s charm. Born and raised in Calcutta, with a father who was president of India’s fourth-largest international trading firm, he has worked for an investment bank and a buyout firm in New York, and in the mid-1990s graduated from Harvard Business School, where he met his current partner Raj Kondur. The two young Indian entrepreneurs became convinced, said Dhawan, that “the next era was the globalization of services, that offshore would be the new phenomenon.” They concluded that India’s potential in this new world was only limited by “the skill set here and what needs to be done in the U.S.” And they sensed a business opportunity thanks to India’s lack of venture capital.

To help fill that gap, Dhawan and Kondur founded Chrysalis, with money from private American investors, the Stanford University endowment and the Economic Development Board of Singapore. The two men now manage a multimillion-dollar portfolio of holdings in, among other things, Indian software firms and Indian companies that do data processing and run call centers for American corporations.

In the global marketplace of information and business services, India has already emerged as a world-class competitor thanks to the convergence of new technologies, a talented indigenous workforce and a serendipitous crisis.

In the 1990s, the falling prices and rising capacity of information technology available around the world permitted the digitization of more and more data. With readily available cheap, high-powered computers with vast memories, the only cost constraint in information services became the salaries of workers who wrote software and input data. Slowly, international firms began to see India’s vast pool of English-speaking, technically trained people as the solution to their problem. Throughout the decade, Citibank, American Express and General Electric tested the Indian waters by moving some of their finance and accounting services to the subcontinent. Then the dam broke when fears of a Y2K crisis hit. Suddenly, global firms needed massive, time-consuming rewrites of their business software and Indian software engineers were their salvation. That work morphed into ongoing contracts to do software maintenance and customization. Telephone call centers were installed to deal with follow-on questions. And the boom in offshoring services was on.

Estimates of the size and performance of the information technology and business processing sector of the Indian economy and the pace of its expansion are rough approximations. Such data is notoriously inaccurate, especially in the developing world. And most of the estimates made by the World Bank, New York investment banks or McKinsey, the consulting firm, are based on data provided by India’s National Association of Software and Service Companies, which has an interest in exaggeration.

Nevertheless, observers generally agree that India’s business process outsourcing sector—international call centers, back-office data processing for foreign firms, and so forth—is roughly a $3.5 billion business, employs about 245,000 people, and has been growing by more than 50% a year since 2000. India’s more established software development sector—which writes code, customizes software, and performs other services for foreign clients—is a $9.5 billion business, employs fewer than 300,000 people and is growing at about 30% a year.

Costs are low. The wage for an entry-level information
and abroad. If the U.S. economic recovery remains sluggish, calls to slow outsourcing—similar to those made during the Democratic presidential primary campaign in 2004—are likely to return with a vengeance. If job creation picks up and incomes begin to rise, outsourcing worries—like fears of the Japan challenge in the 1980s—may fade from the public consciousness.

But whatever happens politically, the underlying economic transformation of the American economy—with more and more service jobs moving abroad—is likely to continue unabated.

**The impact of outsourcing**

Offshoring or overseas outsourcing—particularly the movement overseas of such white-collar service jobs as computer programmer, call-center staff, and X-ray readers—has become a national worry. But the "facts" about offshoring are highly speculative, based on imprecise projections of poorly documented recent trends.

Predictions vary widely of exactly how many and what kind of service jobs are being lost and whether such losses will increase over time.

The most frequently cited estimate, by Forrester Research, a leading business consulting firm, forecasts that 3.3 million U.S. jobs will be shipped overseas by 2015. Forrester has also defined what others now generally accept as the occupational categories most threatened by this outsourcing. These include office and administrative work, which Forrester expects to account for half the jobs moved offshore; information-technology and mathematical work, which will account for one fifth of the jobs lost; and business and financial operations, accounting for one tenth of the job losses.

"It was a projection," said John C. McCarthy, a vice president of Forrester Research who did the estimates. "This isn't an exact science. But we erred on the conservative side. In the 2015 time period, we took the numbers down by a good 25% to make sure we weren't exaggerating."

And some do think the Forrester numbers are too cautious. Ashok D. Burdhan and Cynthia Kroll of the Fisher Center for Real Estate and Urban Economics at the University of California, Berkeley, estimate that as many as 14

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The technology worker is about one eighth that of a comparable employee in the U.S. A project manager, with eight years experience, would still be paid only a quarter of a third of what his or her counterpart in the U.S. might make. A call-center worker earns one sixth what an American call-center worker is paid.

These pay differentials are not likely to narrow any time soon. The technically skilled Indian population is growing faster than the economy can absorb it, ensuring that labor costs will remain low. Service-sector productivity is also improving rapidly and in some cases matches or outstrips Western levels. Turnover in the business processing field, a significant cost factor because new employees need to be trained, is half to a third of that in the U.S.

Slightly more than half of the business processing firms in India are Indian-owned, while four out of five of the information technology services companies are indigenous. But with India permitting full foreign ownership of most information services, U.S. companies are rapidly expanding their beachheads. Electronic Data Systems Corp. (EDS) had 300 employees in India in 2003 and plans to have 2,400 by 2005, according to estimates by Morgan Stanley. Accenture had a staff of 3,500 in India in 2003 and hopes to have 8,000 by the end of 2004. Intel had 950 workers in India and plans to have 3,000 by 2005.

Industry analysts think the services boom in India has legs. As more telecommunications bandwidth becomes available in the next five years, venture capitalist Dhawan sees opportunities for Indians to provide more and more services that require some degree of interaction with U.S. clients. Opportunities include engineering and architectural design, reading of X-rays, support services for doctors, research for the legal and consulting businesses, processing of insurance claims and pursuit of accounts payable.

With such potential, Dhawan estimates that close to a million Indians will be working outsourced business processing jobs within five years, more than a threefold increase in employment. In addition, he expects about 700,000 Indians to be working in information technology, more than doubling the current number of jobs over the same period.

But India's ambitions go far beyond information technology. Indian auto-parts exports have more than doubled in the past half decade, suggesting that the Indian manufacturing sector is finally emerging as a global player. Indian pharmaceutical houses expect to soon be the third-largest suppliers of generic drugs for the U.S. market, doing the research and testing in India.

It would appear that outsourcing of work to India has only begun.

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Then-Foreign Minister for India Jaswant Singh greets Secretary of State Colin Powell in New Delhi on March 16, 2004. Despite mounting concern in the U.S. about jobs being lost to India, Powell said the Bush Administration would not try to stop the outsourcing.
Critical shift

An estimated 3.3 million jobs will be outsourced by 2015, according to Forrester Research.

THE TREND
Numbers are rounded in the forecast.

<table>
<thead>
<tr>
<th>Year</th>
<th>Jobs Outsourced</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>0.1m</td>
</tr>
<tr>
<td>2005</td>
<td>0.59m</td>
</tr>
<tr>
<td>2010</td>
<td>1.59m</td>
</tr>
<tr>
<td>2015</td>
<td>3.32m</td>
</tr>
</tbody>
</table>

GOING ABROAD
Number of jobs expected to move overseas in 2005

<table>
<thead>
<tr>
<th>Office</th>
<th>29,064</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer</td>
<td>295,034</td>
</tr>
<tr>
<td>Business/management</td>
<td>108,991</td>
</tr>
<tr>
<td>Architecture, art, design</td>
<td>53,987</td>
</tr>
<tr>
<td>Sales</td>
<td>27,171</td>
</tr>
</tbody>
</table>


...million jobs could be shipped overseas. Indeed, the Fisher Center’s economists note that in outsourcing circles, some half seriously say that any job mostly involving “sitting at a desk, talking on the phone, and working on a computer” is under threat of offshoring.

Mark Zandi, chief economist of Economy.com, an independent provider of economic, financial and industry research, estimates that offshoring may have already accounted for the loss of 700,000 to 1 million jobs since early 2001. “Moreover,” Zandi observes, “there is little reason to believe that the magnitude of the job losses due to offshoring will abate anytime soon.” And some of those closest to the issue—including venture capitalists and business school strategists who work with offshoring firms—go a step further. They warn, in effect, that we “ain’t seen nothin’ yet.”

The financial services industry, which depends heavily on conducting transactions, has big plans for sending its labor-intensive back-office tasks overseas. Deloitte Research, a business consulting firm, has forecast that by 2010, the 100 largest global financial institutions—most of them in the U.S.—will have moved at least 20% of their business—$400 billion worth of work—offshore.

One need look no further than the bottom line to explain such moves. Celent Communications, another research firm, estimates that the average business school graduate working in the financial services industry in India is paid only 14% of what his or her counterpart earned in the U.S. Call-center workers make 7% of a U.S. salary. And it is not just in India. Hungarian computer programmers start at $4,800 a year; American programmers start at $60,000. Overall, Deloitte thinks the offshoring of financial-services work will save the world’s biggest financial institutions $150 billion a year.

And Forrester’s McCarthy notes that 60% of American businesses are still not participating in the outsourcing trend. But this will almost certainly change. “The range of functions that have been moved offshore successfully is substantial, and widening all the time,” concluded management consulting firm McKinsey & Company in a recent study, “Offshoring: Is It a Win-Win Game?”

McKinsey estimates that because of lower labor costs, offshoring a customer-service call initially saves a company up to 55%, even after factoring in higher costs for telecommunications and management. Firms that reorganize and standardize tasks can save up to 70%.

Just as it was once thought service jobs had to remain in the U.S., jobs now considered immune to outsourcing may be open to being moved abroad in the not-too-distant future. “Geographical and organizational restructuring of the service industry is afoot,” said John Zysman, codirector of the Berkeley Roundtable. The division of labor in service jobs—low-end operations being shipped to India and high-end activities kept in America—may soon break down. Ravi Aron, an assistant professor of management at the Wharton School at the University of Pennsylvania, notes that Singapore now markets itself as a site for managerial, auditing and legal activities to support call centers and the like in the region, including India.

No one can be sure. “All of this predicting going on is fraught with difficulty,” cautioned Kenney of UC-Davis. “But what we do know is that organizations that have tried this have, in general, liked it and are growing their operations quickly. What’s most amazing is the experimentation that is going on—reengineering and moving activities that you never imagined.”

Aron said, “Even though a [U.S.] company may enter into a relationship with an Indian firm because of costs, Pay Disparity

A comparison of average salaries for computer programmers from selected nations

<table>
<thead>
<tr>
<th>Country</th>
<th>Salary Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland and Hungary</td>
<td>$4,800–8,000</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>$5,000–7,500</td>
</tr>
<tr>
<td>India</td>
<td>$5,800–11,000</td>
</tr>
<tr>
<td>Philippines</td>
<td>$6,564</td>
</tr>
<tr>
<td>Malaysia</td>
<td>$7,200</td>
</tr>
<tr>
<td>China</td>
<td>$8,952</td>
</tr>
<tr>
<td>Israel</td>
<td>$15,000–38,000</td>
</tr>
<tr>
<td>Ireland</td>
<td>$23,000–34,000</td>
</tr>
<tr>
<td>Canada</td>
<td>$28,174</td>
</tr>
<tr>
<td>U.S.</td>
<td>$60,000–80,000</td>
</tr>
</tbody>
</table>

India and U.S. Wages Compared


<table>
<thead>
<tr>
<th>Occupation</th>
<th>India</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telephone Operator</td>
<td>under $1</td>
<td>$12.57</td>
</tr>
<tr>
<td>Health Record Technician</td>
<td>$1.50–2</td>
<td>$13.17</td>
</tr>
<tr>
<td>Payroll Clerk</td>
<td>$1.50–2</td>
<td>$15.17</td>
</tr>
<tr>
<td>Paralegal</td>
<td>$6–$8</td>
<td>$17.86</td>
</tr>
<tr>
<td>Accountant</td>
<td>$6–$15</td>
<td>$22.35</td>
</tr>
</tbody>
</table>

Source: The New Wave of Outsourcing, Authors Des Barra and Cynthia A. Krall

The point is that international comparisons support the idea that a few good jobs are a lot better than a whole lot of bad ones—and that many kinds of work can be performed successfully anywhere in a world where technology and communications are more or less equal.
OUTSOURCING JOBS

You're looking at it as a chore, son. Instead, look at it as a valuable lesson in global economics, I used to rake the leaves myself, but my time was worth too much. So now, I'm outsourcing it to you.

it discovers that it gets much better quality than it had expected . . . So companies start out for cost, stay on for quality, and then realize that they get a lot of managerial initiative" from their Indian partners as well.

What it means for the U.S.
Community by community, Americans are coming to grips with how the shift in the economy will affect them as they realize just how many different kinds of white-collar jobs can be "funneled" over the Internet and fiber-optic cable to exotic places.

Milton-Freewater, a town of 6,500 in depressed eastern Oregon, thought it had found the solution to its economic woes six years ago when it successfully wooed Sykes Enterprises to set up a call center there. The facility brought in nearly 500 jobs paying around $10 an hour. But in March 2004, the company announced it would close the Milton-Freewater call center and expand operations in the Philippines and elsewhere abroad. Milton-Freewater had provided Sykes with $3.5 million in economic development assistance to locate there.

But the real impact of white-collar offshoring is most likely to be felt in major metropolitan areas, where most "at-risk" white-collar jobs are found, according to Bardham and Kroll. These include cities heavily dependent on high-tech such as San Francisco, San Jose and Boston, as well as business and finance centers like Atlanta. Roughly 15% of employment in these cities is in the occupations most likely to be shipped offshore. The jobs most at risk in these urban areas are the highest-paying, with salaries 20% to 60% above the national average.

This will spell trouble for the local economies beyond lost income. As jobs flee abroad, they will leave empty offices in their wake.

"Offshoring of knowledge-based jobs poses the greatest threat to America's office markets since the massive overbuilding of the 1980s," wrote commercial real estate consultant M. Leanne Lachman, in a new report jointly published by Columbia University's Paul Milstein Center for Real Estate and the Urban Land Institute. With vacancy rates already high, wrote Lachman, "the prospect for office-building owners and developers is sobering."

And the consequences for cities and suburbs that depend on property tax revenues from those empty office parks to pay for schools and maintain roads could be even worse.

Mitigating factors
Of course, projections of the numbers of jobs being moved offshore need to be put in perspective, as other events affect jobs in America as well. "[The 'do-not-call' list . . . eliminated more call-center jobs in the U.S. than will move to India . . . in the next 10 years."

said Harris N. Miller, president of the Information Technology Association of America.

And the loss of U.S. information-technology jobs is also linked to the disappearance of manufacturing jobs. As Jacob F. Kirkegaard, a research assistant for the Institute for International Economics, noted in a recent paper on outsourcing, "Discussion of white-collar job losses in the U.S. cannot be separated from [economic problems] in the manufacturing sector . . . . The vast majority of the jobs lost in the post-bubble U.S. economy from 2000 to 2002 in occupational categories threatened by offshore outsourcing has occurred in the manufacturing sec-

A Delta airlines employee helps a customer at Chicago's O'Hare airport. The airline says it saved so much money by moving call-center jobs to India that it was able to hire more sales and reservation agents in the U.S.
tor.“ For example, many data-entry and other back-office jobs at steel mills and other factories disappeared when the factories shut down. These jobs were not sent offshore; they simply were eliminated.

The job-loss numbers may also appear worse than they are. Forrester estimates an average of 220,000 jobs lost to offshoring per year. In a good year—which we admittedly have not seen recently—that is how many jobs are created in the U.S. each month. Zandi’s estimate of jobs already lost to outsourcing works out to just 6,723 jobs per week. Between 2001 and 2003, the number of new unemployment claims in the U.S. averaged 301,000 per week—only about 2% of the number lost to outsourcing. And Catherine L. Mann, a senior fellow at the Institute for International Economics, points out that the number of private-sector, white-collar service jobs in the U.S. increased by 1.5% in the period between February 1999 and October 2003, suggesting that outsourcing is not crippling service employment in this country.

Some analysts also contend that expectations about the future pace of offshoring are widely exaggerated. “Long distance is not better than being there,” said Forrester’s McCarthy. Managers want control, and customers want proximity. Companies will only want to send a limited number of jobs overseas, McCarthy contends.

Moreover, of the 16 million jobs created in the U.S. between 1993 and 2003, roughly two thirds were in the health care, education and professional services, according to David Wyss, chief economist at Standard & Poor’s. These jobs may prove largely immune to outsourcing, for a variety of reasons.

Teaching jobs are unlikely to move to India, if only because students and parents want teachers to personally interact with students in classrooms. X-ray-reading jobs may move to India, but nursing requires personal interaction with patients. In fact, in recent years, the nursing profession has experienced extensive “onshoring,” as residents of the Philippines and other countries move to the U.S. to fill nursing jobs. Government employment has also shown significant growth over the past decade. Constituents want more services, and voters are unlikely to allow their tax dollars to be used to send those jobs abroad.

Businesses are also cautious by nature. Stanford’s Dossani notes that companies’ interest in moving work to South Asia slowed for several months in 2002 because of the military face-off between India and Pakistan. In late 2003, Dell Computer pulled some of its call centers back to the U.S. from India because of adverse customer reaction to Indian operators. Dell’s move prompted some medium-sized U.S. firms to postpone contemplated moves to India.

And not every job created in India means that an American job has been lost. For example, in the past, U.S. airlines did not pursue small billing discrepancies with travel agencies because it was not worth the cost. Now, using cheaper Indian labor, air carriers can afford to correct billing errors. For the airlines, it is found money. For India, it is new jobs. For America, it means no job losses because that work never existed in the U.S.

Moreover, sending jobs offshore creates economic efficiencies that can lead to new job creation in the U.S., much as the offshoring of computer manufacturing did in the past decade. “Globalization of software and services will entail some jobs being done abroad, but will result in lower prices for the overall information-technology package,” said Catherine Mann, author of the study “Globalization of IT Services and White Collar Jobs: The Next Wave of Productivity Growth.” Outsourcing is just part of a cycle of change that will strengthen the U.S. economy, Mann contends.

“The resulting greater use of information technology will propel the U.S. toward a new wave of faster productivity growth that yields a greater demand for IT-related jobs,” she said.

Barry Bosworth, an economist at the Brookings Institution, agrees. Software made more cheaply in India will spur increased use of software in health care and education, he said. That will, in turn, boost productivity in those parts of the American economy and create jobs for U.S. workers, who will manage and manipulate the software. As technological labor is sent abroad, new businesses will emerge at home in biotechnology, energy, medicine and nanotechnology.

These economic trends will dwarf the impact of offshoring, say mainstream economists.

**Evolutionary or revolutionary?**

Whether, on balance, the use of offshore workers will hurt or help the U.S. economy and American workers depends on whether sending jobs abroad is just the next step in the generally beneficial evolution of the modern global economy or whether it is a dangerous leap into uncharted territory. On that question, the jury is still out. Economists can, and do, argue both sides of the issue.

The offshoring debate “is perceived as something that is completely new and completely different,” said Lael Brainard, a senior fellow in economic studies at the Brookings Institution. “The reality is that it’s really a logical continuation of what we’ve seen in manufacturing, with the business system being developed and whatever pieces [that] aren’t absolutely critical to the value of the firm being moved to the lowest-cost locations... The same thing is now...
NEW WORRIES ABOUT AN OLD THEORY

The controversy over shipping jobs overseas has revived an old debate about the rationale for free trade, a tenet that most economists had long accepted as gospel.

As economist and New York Times columnist Paul Krugman once wrote: "If there were an Economist's Creed, it would surely contain the affirmations: 'I believe in the Principle of Comparative Advantage,' and 'I believe in free trade.'" Two centuries ago, British economist David Ricardo asserted the mutual benefits of free trade with his theory of "comparative advantage," the cornerstone of all subsequent justifications for international commerce. Ricardo argued that a country is better off if it specializes in what it is most efficient at producing and then trades with other nations to obtain whatever other goods and services its citizens might want. Ricardo contended that trade is beneficial even if a country is not the lowest-cost producer of any particular good or service. Even if China, to choose a modern example, could produce everything the U.S. produces more cheaply than America, it would still make sense, according to Ricardo's theory, for the Chinese to concentrate on producing what they are best at and to let the Americans produce the rest.

Periodically, skeptics have challenged Ricardo's ideas, but each time this theory has proved valid. Now doubters worry that the easy mobility of capital and technology calls the theory of comparative advantage into question. These critics argue that classical economics in general, and Ricardo's theory in particular, assumed that the three main factors of production—land (or natural resources), labor and capital—could not move between countries. Clearly, that assumption no longer holds. "Comparative advantage is undermined if the factors of production can relocate to wherever they are most productive—in today's case, to a relatively few countries with abundant cheap labor," wrote conservative economist Paul Craig Roberts and Senator Charles Schumer (D-N.Y.), in a January 6, 2004, Op-Ed piece in The New York Times. "In this situation," they wrote, "there are no longer shared gains—some countries win, and others lose."

Moreover, those who question Ricardo note that India has a labor pool of 14 million to 22 million high school graduates who have a reasonable command of English. With so many Indian workers available, multinational companies will be able to exchange higher-priced U.S. labor for skilled, lower-priced Indian labor for years to come, using lower-cost computing and internet communications to break down the old geographic boundaries between labor markets. "If you don't believe that changes the average wages in America," economist Paul Samuelson, the dean of American economists, told The New York Times, "then you believe in the tooth fairy."

But traditional economic theory teaches that purchasing cheaper call-center or programming services from abroad reduces costs for various other industries, delivering a net benefit to the economy and the American consumer. That may no longer hold. "Being able to purchase groceries 20% cheaper at Wal-Mart," Samuelson said, "does not necessarily make up for the wage losses" Americans are now experiencing.

Moreover, America's reliance on lower-paid foreign labor will increasingly move beyond low-skilled jobs. "A lot more of the value chain is being outsourced," said San Francisco-based investor Michael Borrus. "It's not just quantitatively so; it's also qualitatively so. You are seeing start-ups in Silicon Valley do more complex initial product development offshore."

Mainstream economists counter that Ricardo's critics either woefully misunderstand or willfully misrepresent the theory of comparative advantage. "Economic theory can accommodate the expansion of the labor supply," said Lael Brainard, a senior fellow at the Brookings Institution in Washington, referring to the unprecedented entry of tens of millions of new Indian and Chinese workers into the global marketplace. But, she admits, "the kinds of pressure that puts on [U.S.] wages, especially if the benefits take a long time to come on line—that is a question mark."

So even if the theory of comparative advantage still holds, and even if offshoring will eventually deliver economic benefits to both Indians and Americans, economists acknowledge that the timeframe in which this will occur is not relevant, at least politically. "Economists can reassure themselves that the theory is right and that things will work out for the best," said Jared Bernstein, a senior economist at the Washington-based Economic Policy Institute, "but these [offshore job] displacements are not a short-run phenomenon."

Or, as another economist, John Maynard Keynes, noted years ago, the problem with economists is that they think all problems will eventually solve themselves. That may be true, he lamented, but "in the long run we're all dead."
volutionary vision of the economy fits the revolutionary nature of today’s job market, where new anomalies suggest that the future may not look anything like the past.

For one thing, the pace of economic change is simply faster now than ever before. The offshore migration of manufacturing jobs took place gradually over the past four decades. Even at that slow pace, American workers and communities had a difficult time adjusting. Some have still not adjusted. The movement of service-sector jobs offshore has been compressed into a decade.

Today’s economy also radically differs from the economy during previous periods of change. The last recession officially ended in November 2001, yet jobs had not completely rebounded by fall 2004, making it the longest “jobless recovery” on record. The rate of long-term unemployment—that lasting six months or longer—during this recovery was the highest since the recession of 1983. Between 2000 and early 2004, the number of long-term unemployed among workers faced with offshoring tripled for management, business and financial occupations, and doubled for office and administrative-support occupations.

And, the sad fact is, many of these jobs may never come back. A 2003 study by the Federal Reserve Bank of New York concluded that job loss in the last recession was primarily structural rather than cyclical, meaning that those jobs will be unlikely to return even with an economic rebound. It is little wonder that some people view the shipping of jobs overseas as part of a menacing new economic environment.

A look at the future of service work is also not very reassuring. According to the U.S. Bureau of Labor Statistics (BLS), the U.S. in 2012 will have 4.42 million information-technology jobs. That may seem impressive, except that the estimate is down from the previous BLS projection of 4.9 million such jobs in 2012. In addition, over half—54%—of the 3.4 million jobs expected to move offshore by 2015 are those that currently pay above the U.S. median wage of $28,580, according to analysis by the Progressive Policy Institute.

Concern has also begun to arise about the long-term impact on U.S. competitiveness from offshoring some entry-level information-technology and technical-research jobs. “The capacity for innovation, which underpins job creation tomorrow, is powerfully influenced by location decisions made today,” warned Berkeley’s Zysman.

How do young Americans get a start up the information-technology career ladder when the first few rungs of that ladder have been moved to India? “It is by no means a ‘plus’ if offshoring results in the loss of good jobs and the erosion of competencies in our key high-value-added industries,” said Robert Atkinson, director of the Technology & New Economy Project of the Progressive Policy Institute.

Moreover, the loss of low-skilled jobs could undermine American workers’ efforts to improve their skills and income. Rosemary Batt, Larry W. Hunter and Steffanie Wilk, in the recent book Low-Wage America: How Employers Are Restapping Opportunity in the Workplace, argue that moving low-end jobs overseas makes it hard for Americans earning low-wages to get better at what they do. “When telecommunications firms handled customer service locally,” they concluded, “call-center operators could increase their earnings by being promoted from servicing residential customers to servicing small-business customers, and eventually to serving larger business clients. This type of movement is now rarely possible,” because of the relocation of call centers overseas.

The role of technology

Whether offshore outsourcing revolutionizes the way Americans work or is merely a passing fancy may depend on whether technological developments make outsourcing even easier or whether new technologies eliminate the need for sending work abroad by automating it in the U.S.

Many jobs now being moved offshore may soon disappear completely as machines replace human beings. “Much of what the Indians are doing comes right before it gets automated,” said Atkinson. “Take medical transcription (which is increasingly being done in India or the Philippines). It may not be a big industry in 10 years,
as voice-recognition software allows it to be done automatically.”

But new technologies could lead to the transfer of even more kinds of work overseas. Wall-sized plasma TV screens and broadband communications may overcome much of the need for face-to-face contact in collaborative work, especially among younger workers accustomed to computers and instant messaging. New technologies will also allow corporations to trade nearby control for long-distance monitoring, Aron said. “I will no longer need to have a person sitting in Manhattan, right under my nose. He can be sitting in Madras, and I can still monitor him.”

Can—and should—it be stopped?

There are a range of proposals about what to do about offshoring—everything from accepting it as inevitable and finding better ways of coping to trying to end it. But there is little assurance any government policies can affect the movement of jobs abroad.

Most experts—whether liberal or conservative—agree that offshoring work abroad is likely to grow over time and that the only way Americans can compete with Indians or Chinese is to be better educated, more innovative and able to work smarter. If workers are better educated and more productive, they can trump the cost advantage that businesses seek in hiring less-expensive foreign workers, particularly in service industries. In essence, this theory says American workers must run faster to stay ahead of the competition from cheaper foreign labor.

But the U.S. has been trying to improve its educational performance for a generation, with mixed results. Even if public investments in the schools work, they will not show a return for at least a decade or more. That will have little effect today.

To address immediate concerns about job loss, some observers have proposed giving tax credits to firms that create jobs in the U.S. and removing whatever tax incentives exist that may reward corporations for shifting work abroad. Tax benefits could prove expensive, however, and companies may ask for tax breaks for jobs they would have created in America anyway.

Other critics say that more needs to be done to help those who lose their jobs due to outsourcing. Currently, Trade Adjustment Assistance, the government’s program to help with retraining for a new job, does not help an American computer programmer in Silicon Valley, Calif., whose job is shifted to India. It does provide aid to steel and textile workers. But white-collar service workers are the new victims of globalization and deserve help just like manufacturing workers.

Other proposals simply attempt to put the brakes on outsourcing. The January 2004 Omnibus Appropriations bill passed by the U.S. Congress prohibited sending work for the U.S. Transportation and Treasury Departments overseas. The ban is economically irrelevant, however, because it affects less than 2% of the information technology work currently in India. Other proposals would extend that prohibition to all federal procurement of goods and services and to all state government procurement using federal funds.

At the state level, before the offshoring controversy began, call centers for 42 states and the District of Columbia operated offshore. In response to the public outcry against outsourcing, New Jersey has now brought all its call centers back to the U.S., and Arizona, Kansas, North Carolina, Oregon and Wisconsin are planning to do the same.

Such bans pose difficult choices for cash-strapped local governments. The prohibitions end up retaining jobs, but at a very high cost per job. Money is then not available to provide other needed government services. So some states have opted for disclosure rather than banning offshore outsourcing outright. Minnesota and Missouri require state contractors to disclose where they plan to perform work for the state so that lawmakers and citizens can make an informed decision about whether the cost savings overseas are really worthwhile.

Conclusion

In the end, the debate over moving service jobs offshore will most likely continue for years to come. The trend is driven by history, technology and broad economic forces. “What we are facing are the two faces of globalization,” Mann said, “the gains, and the indirect adjustment costs. They are both equally important.”

There are no easy solutions to the economic and political dilemmas posed by offshoring. There are only tough choices that citizens, consumers and workers will have to make. •

OPINION BALLOTS
PAGES 45–46
1. Is outsourcing work offshore to India or elsewhere simply the next phase in the evolution of modern capitalism and thus not something to be resisted but to be embraced? Or is it an unprecedented development driven by new technologies that could threaten future U.S. prosperity?

2. Does the availability of millions of well-educated, low-wage workers in India and elsewhere call into question traditional theories of free trade, raising doubts about whether U.S. workers can continue to compete in a world with so much surplus labor that will drive down wages?

3. Is the level of offshore outsourcing projected for the future tolerable for the U.S. economy and thus not something to be that worried about? Or is the movement of American jobs overseas just the tip of a job-lose iceberg that requires government intervention?

4. Do you think new technology will hasten offshore outsourcing, as more work can more easily be shipped abroad, or will it automate many jobs now being sent overseas and so bring the tasks back to the U.S.?

5. Should people who lose their jobs due to offshoring be eligible for government retraining assistance or are white-collar, high-tech workers who lose their jobs to foreign competition capable of finding new work on their own?

6. Should governments ban the offshore outsourcing of work paid for by taxpayers or would the extra tax dollars that would be spent to keep those jobs in the U.S. be better spent on other government services?

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www.danielerezner.com/blog Published by one of America’s most skilled and prolific economists, this weblog analyzes the effects of outsourcing on the economy and suggests that the trend will be positive for both the domestic and global economies.

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