Do the benefits of outsourcing outweigh its costs?

When we hear the word “ outsourcing” used in the media, it is commonly associated with negative overtones about tragic consequences for the American worker. There are countless interviews with factory workers who say that they factories have been shut down and their livelihoods evaporated because American jobs are moving overseas. Thus, the impact of outsourcing, especially on blue-collar workers, have been portrayed as negative. However, this image of outsourcing is decidedly different among many economists, who say that though outsourcing have minimal negative impact on U. S. workers, these pale in comparison to the befits of outsourcing for the economy.

Background

According to the United States Government Accountability Office’s (GAO) Report to Congressional Committees in 2005 entitled “ Offshoring of Services: An Overview of the Issues,” outsourcing is not a new phenomenon.” In previous decades, U. S. manufacturing companies were motivated to offshore because of the low costs and availability of skilled labor, production and supply networks in some developing countries, and reductions in cost of transporting goods” (13). It is estimated that the practice has been in effect for the past 16 years, though the idea has been around since the Cold War when the U. S. England, Ireland and Israel began opening up their doors to international trade which results in the exchange of jobs and services. At the end of the Cold War, countries such as India and China began opening up their doors to free trade, and began outsourcing activities with the United States (“ Offshore Outsourcing: Impact on the American Workplace,” p. 2). By definition, offshoring or outsourcing is the practice in which U. S. companies or government entities replace goods or services previously produced domestically with services and goods produced abroad. In the process, U. S. companies divide their production operations into different segments, so that some of their components can be offshored. This may include the offshoring of production process or parts of the process, while the company retains its " higher-end, higher-skilled services functions in the U. S., such as management, finance, marketing, and research and development" (13). Advances in technology such as telecommunications capabilities and the birth of the Internet, which have made it possible for workers around the world to communicate more effectively and increase standardization and digitization, have spurred the growth of outsourcing.

Despite the fact that outsourcing is not a new phenomenon, it is one of the most controversial and contentious issues in the area of economics and politics today. In " Foreign Outsourcing Invigorates US Economy," Daniel Griswold of the Cato Institute points out that

American executives and managers who practice outsourcing every day must be puzzled by how controversial the practice has become among politicians. Lawmakers in Congress and in more than 30 states have targeted foreign outsourcing as a threat to US employment and prosperity. Along with certain critics in the news media, such as CNN' Lou Dobbs, they charge that US companies are firing Americans workers in significant numbers and replacing them with foreign workers in low-wage countries such as India. Legislative proposals have focused on barring federal or state contracts with companies that would ' offshore' the work to call centers or IT providers abroad. (p. 1)

To best understand the controversy over outsourcing it is necessary to explore the arguments for and against outsourcing.

Arguments for Outsourcing

In Outsourcing America: What's Behind Our National Crisis and How We Can Reclaim American Jobs, Ron and Anil Hira discuss four main reasons offered by experts why companies should engage in the practice of outsourcing. The first reason is the view that American workers lack certain skills because of our poor education system and because a limited number of young people are studying science and engineering. The second reason is that American companies are under a lot of pressure as a result of global competition, which requires them to outsource to gain access to local markets outside of the U. S. The third explanation is that outsourcing does not result in a loss of significant number of jobs outsourcing simply gets rid of low-paying jobs, leaving higher paying jobs which require only a simple upgrade of skills. The fourth argument for outsourcing is that outsourcing will lead to a creation of new jobs and that the white collar workers who are temporarily displaced will be able to “ bounce back” as did the blue-collar workers who were affected in the economic turmoil of the 1980s (26-29).

Arguments Against Outsourcing

Critics of outsourcing believe that it is bad for the American economy, primarily because it destroys American jobs. According to Carl Steidtmann in “ The Macro-Economic Case for Outsourcing,” opponents of outsourcing argue against the practice on the basis that it amounts to the shipping of good American jobs to undeserving foriegners, while creating poverty in America. According to State Senator Shirley Turner, who sponsors a bill to prohibit New Jersey's companies from outsourcing services outside of the U. S.," Neither the people in India who have the jobs, nor the people who are unemployed here in the U. S., are giving anything back in the way of taxes or buying and consuming U. S. goods and services, which is what stimulates our economy. By outsourcing these jobs to other countries we're helping the poor remain poor in this country" (Steidtmann 1). Some economists also believe that outsourcing causes America to lose its competitive advantage to countries such as China and India and that this represents permanent loss for the American worker and the economy.

Assessing the Impact of Outsourcing

Despite the view by some ardent supporters of laws to squash outsourcing such as CNN's Lou Dobbs, many economists believe that outsourcing will have an overall positive impact on the U. S. economy. The general consensus among outsourcing advocates' is that there will be " some temporary dislocation in low-skill jobs because of outsourcing but assert that the practice offers substantial gains to the U. S. economy through cheaper imports and stronger markets for exports" (Olian 1). The effects on jobs is also believed to be minuscule. The reason for this is that service sector jobs (e. g., retail, catering, personal care, and some professional roles), which account for 70 to 80 percent of the U. S. economy, cannot be outsourced because these jobs, by nature, involve a personal interaction between the consumer and those delivering them.

Data collected by Forrester Research, an IT consulting organization supports the view that outsourcing will have only minuscule impact on jobs in the U. S. It is found, for example that by the end of 2003, about 400, 000 U. S. jobs moved to other countries because of outsourcing. The number is expected to hit 3. 3 million by 2015. However, this is estimated to be about 200, 000 jobs lost per year to global outsourcing. This is considered a “ trivial problem in the context of the normal churn of the U. S. economy, where about 7 million jobs were gained and lost in each of the last four quarters” (Olian 1). According to the study by Global Institute, 90, 000 new jobs were added in 2003, and approximately 317, 000 net new jobs will be added by 2008 (“ Outsourcing Creates Jobs, Study Says,” p. 1).

Who Benefits from Outsourcing

To determine whether outsourcing is good for America, it is important to consider who actually benefit from outsourcing. The McKinsey Global Institute identifies corporations as the main beneficiaries of outsourcing. “ The key findings are that companies will save tremendous amounts of money by outsourcing; the U. S. economy will gain from outsourcing; and even most Americans workers will benefit” (Hira & Hira 30). It is estimated that global outsourcing provides corporations with about 45 to 55 percent returns in net saving on sales from American products, especially IT products. It is believed that the U. S. economy benefits from outsourcing because it results in cheaper imports. For example, it is found that the price of computers dropped by 10 to 20 percent in the early 1990s because U. S. chip makers moved offshore to reduce the price of the chips they used in computers (Olain 1). A 2003 report by Diana Farrell at the McKinsey Global Institute in 2003 found that “ outsourcing delivers large and measurable benefits to the US economy. It reduces costs for information technology (IT) as much as 60 percent, keeping US companies competitive in global markets, benefitting workers and shareholders alike” (Griswold 2). The McKinsey report indicates, for example, that for every $1 spend on foreign outsourcing, $1. 12 to $1. 14 of additional economic activity is created in the U. S., economy.

That outsourcing will have long-term positive benefit on the U. S. economy is based on the idea that the benefit of importing services is similar to that of importing goods, the most significant of which is improvement in productivity. This is because “ the buyer is able to get more for less. Increased trade also forces domestic producers to be more productive in order to remain competitive. Improving productivity raises the standard of living, puts downward pressure on prices and gives a boost to profitability and wages” (Steidtmann 2). This view is based on evidence of improved productivity in the U. S. during the 1990s, which is directly attributed to expansion of free trade caused by North American Free Trade Agreement (NAFTA) and the expansion of the General Agreement on Trade and Tariffs (GATT). The explanation is that “ the growth in imports and the corresponding improvement in productivity pushed prices of goods down, improving the purchasing power of everyone. An increase in trade for services will have the same laudatory effect on the service sector of the economy in the coming decade that increased trade in goods had on the goods sector in the 1990s” (Steidtmann 2).

As to the argument that outsourcing have caused a dramatic increase in unemployment, the evidence is mixed. Research supports the opponent’s arguments that outsourcing results in the permanent lost of some American jobs. For example, a study at the University of California-Santa Cruz which examined manufacturing jobs that were lost between 1979 and 1999 in labor-intensive industries such as the clothing industry, found that one-third of the displaced workers did not find reemployment within a three-year period. Those who did find employment experienced significant wage cut by at least 15 percent. A Business Week report indicates that manufacturing workers are not the only ones at risk, but a large number of the 57 million U. S. white-collar and professional employees also face the risk of having their jobs outsourced because of global competition (Olian 1-2).

Despite these findings, the GAO, a bipartizan congressional agency, “ only a small fraction of significant layoffs by large employers can be directly attributed to overseas outsourcing of work. ” (“ Outsourcing Still Small But Growing Fast,” p. 1). In addition, though some experts predict that outsourcing will result in the elimination of 100, 000 to 500, 000 IT jobs in the next few years, some experts also predict that there will be an overall growth in the U. S. economy due to the direct benefits of outsourcing such as lower prices, productivity improvements and growth in job sectors that use offshored services. The study by Global Insight reveals that the befits of outsourcing to the American economy include lower inflation, increased productivity and lower interest rates, which further stimulate business, consumer spending and overall economic activity. The study further indicates that $33. 6 billion was added to the U. S. gross domestic product (GDP) in 2003 because of outsourcing and that as much as $124. 2 billion could be added by 2008. In addition to an increase in the number of new jobs, the study indicates that U. S. workers already benefitting from outsourcing because it has raised the wages of U. S. workers by 0. 13

percent in 2003 and is expected to raise wage by 0. 44 percent by 2008 (" Outsourcing Creates Jobs, Study Says," p. 1).

Despite the fact that outsourcing is not free of problems, the overall benefits, at least in the long term, appear to outweigh the cost. This is the finding from the research. Aside from the fact that outsourcing will undoubtedly result in temporary displacement of some American workers, opponents have not made any strong argument why outsourcing is not a sensible economic strategy. On the contrary, the proponents have identified a number of reasons and data in support of outsourcing. The general conclusion at this time therefore is that outsourcing has an overall positive benefit on the U. S. economy.