

## Outsourcing

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Like a comet flashing across the sky, everybody notices and has something to say about outsourcing. The outsourcing phenomenon and the reaction it generates, unlike a comet, is unlikely to be short-lived; my guess is that the response will be more like the hula hoop, fanatic for a time and then more restrained. The movement of jobs overseas is not a new development, as has repeatedly been pointed out by the pundits. What is different this time is that the people losing jobs are well educated and know how to work the system. The movement overseas in this go-round is in the skilled and semi-skilled service sector where the United States has long been the pioneer. We are still number one in high-tech services, but there is now uncertainty below this level.

A distinguished group of observers has commented on the outsourcing issue as it now manifesting itself. Tom Friedman, the *New York Times* columnist, visited India and China and gave a balanced picture on winners and losers in the two countries and in the United States. The chairman of the president's council of economic advisors, Gregory Mankiw, stated that in the long run, this movement of service jobs overseas will be beneficial to the U.S. economy in that it will lower costs and create even more jobs by making U.S. industry more competitive. He was berated for saying what he did by the by others in the Bush administration and by the speaker of the House of Representatives, Dennis Hastert, for not understanding the seriousness of these job losses. Jagdish Bhagwati, a senior scholar on trade issues, has been making the rounds to publicize his most recent book, *In Defense of Globalization*, and, in the process, arguing that if the United States acts to stop outsourcing, our developed country competitors will not; and we might save 10 jobs at the cost of losing 100. This is essentially the same argument made by Mankiw.

Senator Charles Schumer (Dem-NY) has argued that this movement of skilled jobs overseas shows that comparative advantage is no longer relevant because countries can import these advantages. (What else is new?) The U.S. Congress will almost certainly enact legislation to slow down the process of outsourcing. Protectionism, drawing much of its inspiration from the outsourcing issue, became a major issue

in the Democratic primaries and surely will carry over as an issue in the presidential and congressional elections this coming November. The former president of Brazil, Fernando Henrique Cardoso, referred to outsourcing as a form of Schumpeterian "creative destruction," and as being potentially beneficial for countries like Brazil if they can develop the necessary technical expertise in a wide area of activities.

I have in front of me a number of magazine comments. From the *Economist* of February 21: "The fact that foreign competition now impinges on services as well as manufacturing raises no new issues of principle whatever." From *Business Week* of March 1: "This exodus throws the future of America's tech economy into question." Or to cite Martin Wolf in the *Financial Times* of February 25: "US legislators need to take a grip of themselves. Attacking cheap imports of services is no more logical than bemoaning rising productivity. The US, they should remember, benefits hugely from both." A *USA Today* public opinion poll reported on February 24 showed that support for globalization in the United States fell from 53 percent in 1999 to 40 percent today.

The current concern is stimulated by two underlying developments: the phenomenal rise in productivity, i.e., the ability to produce more with fewer workers; and the slow growth in job creation. U.S. productivity rose by 5 percent in 2003, compared with a 20-year average rise of 2 percent a year. If the United States wishes to be a competitive nation with high salaries and low inflation, there is no substitute for productivity growth. But, at the same time, the jobs saved by growing productivity must be replaced by job creation in the economy as a whole. More than 20 million jobs were created during the 1990s, whereas job loss from 2001 to the present has been 2.2 million. It is impossible to speak with certainty about the durability of the current concern about outsourcing because there is no certainty about the prospects for better job creation in the U.S. economy. Last month (February) the economy produced only 21,000 jobs; the monthly average of job creation in the 1990s was 200,000

Job turnover in the United States was 42 million in 2003. Most of this comes from the domestic economy; imports are less than 15 percent of U.S. gross domestic product. This churning does not become a transcendental issue as long as those losing their jobs can find new ones that are more or less equal in a reasonably short time. However, about 22 percent of unemployed persons over 16 years of age take six and one-half months or more to find a new job. This is a key part of the problem. Scapegoating foreigners, however, does not solve the problem. Outsourcing has become the current demon but, to date, the most common estimate of the number of outsourced jobs is 300,000 as compared with a U.S. labor market of 130 million. At a recent meeting, the former president of Mexico, Ernesto Zedillo, asked rhetorically what the U.S. complaint was when 300,000 out of 130 million jobs were going to countries that are important U.S. markets.

There are social Darwinians who believe that the market makes the correct determination of who works and who does not; who rises and who stagnates; and that this should be allowed to follow its course without government involvement. My view of advanced societies is not that libertarian. I prefer to think of advanced capitalist societies, including the United States, as being based on a compact in which the market dominates but with the government playing the role of compensator or intermediary in making relatively modest resource transfers (in relation to the size of the economy) to the losers. This view is accepted generally in Western Europe, but less so in the United States. The compensation can take many forms: payments for a limited time cover some portion of wage loss; and protection against the loss of health insurance in a system based on one's job. "Radical" ideas along these lines have come over the years from people as diverse as Bismarck and Richard Nixon.

The attention in recent outsourcing concerns has focused on a few areas, although these are not the only ones in which outsourcing is taking place: call centers; computer programming; X-ray diagnoses. Earlier comparable outsourcings, such as setting up centers to record accounting data and to operate the complex on-line airline-scheduling systems were accepted with greater equanimity. The current outsourcing tasks undoubtedly require greater personal skills, but they are not the most advanced skills in a high-tech economy. The future of the U.S. economy does not rest on retaining the jobs now being outsourced, but on the creation of a population with ever-greater skills. We are doing much in-sourcing as well, such as for college professors (especially in the hard sciences), computer programmers and other technicians, and nurses. When we skimp on education budgets, the logical outcome is the continuation of both outsourcing and in sourcing.

Support for open trade, whether in services, agriculture, or manufacturing, is all based on the same premise: that this

augments domestic and international welfare. We are better off as a country when our trading partners are rich rather than poor because we can sell them more. In 2003, our merchandise exports to Canada, with a population of 32 million were \$169 billion, and to Mexico, with a population of 105 million, our exports were \$97 billion. We can't arbitrarily close our market to the products of others without expecting them to do the same to our products.

Yet, there is no doubt that people and towns are hurt from international trade. These hurts are real and an advanced society should not ignore them. This is the rationale for a system of compensation to the losers, something that the United States has never done well. The more basic solution, however, has to be substantial job creation so that those who lose jobs have other opportunities—and, on this, we are currently failing. The issue of job loss was a secondary one in the 1990s because many new jobs were being created, whereas job loss is now a dominant issue—and, in my view, rightly so.

Protectionists remind us regularly that international trade creates losers. And, so it does. So, too, do changes in the domestic economy—indeed, many more losers than result from international trade. We must remind ourselves regularly that the lack of change—trying to keep what we now have without disruption from domestic or foreign influences—also brings losers. Where would the United States be today without the changes (and initial job losses) that gave us the automobile industry, computers, new drugs, new materials, and other innovations?

It is impossible to predict how much further outsourcing will go, what avenues it will take, and what anti-outsourcing action the U.S. government will put into place. The danger is that the issue has swept Washington like a wildfire out of control and there are demands for immediate action to stop or slow the process. Don't just sit there, do something! And doing things in this atmosphere is exceedingly dangerous because anything that is done is almost certain to be restrictive and not creative. We are taught as youngsters that the U.S. Senate is one of the world's great deliberative bodies. The sense I'm getting is that it is anything but.

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