

Outsourcing: A Policy Agenda

By Sarah Anderson and John Cavanagh | April 2004

“Don’t worry; they’ll get better jobs in the service sector.” During the last three decades of the 20th century, this was the mantra of most government and business leaders when corporations transferred auto or apparel jobs to Mexico or China. That line doesn’t work anymore, since U.S. companies have started shifting a wide range of service jobs as well—from high-skill computer programming to entry-level call center jobs—to India and other lower-wage nations. This breaching of the final frontier of American jobs has caused understandable anxiety and has become a hot-button issue in the presidential election campaign.

The trend toward foreign “outsourcing” of service jobs is an extension of a longstanding practice of cutting costs by subcontracting parts of business operations to nonunion shops within the United States. The practice has gone global, in part because of

technological changes. Massive amounts of information can now be transmitted across the world at low cost, making geographic distances less important. International financial institutions and trade agreements have also facilitated the trend by promoting investment liberalization and privatization of public services, creating new opportunities for U.S. corporations in overseas markets.

Forrester Research estimates that about 40 percent of Fortune 1,000

Key Points

- Although the number of U.S. service jobs lost to outsourcing is currently small relative to the total work force, the fear of a seemingly limitless loss of jobs to lower-wage countries has caused widespread anxiety.
- U.S. companies dominate global services outsourcing, and India is the top developing-country destination.
- National and state legislators have introduced a flurry of anti-outsourcing bills, but corporations are mounting a strong counter-attack.

firms have already outsourced some work and that at least another 3 million service jobs will leave the United States by 2015, led by information technology work. A study by the University of California, Berkeley estimates that 14 million U.S. jobs (11 percent of the total work force) are vulnerable to being outsourced.

Although the number of jobs lost so far is small relative to the total work force, these layoffs have a huge impact on the affected communities, and the potential for white-collar jobs to be offshored is deeply unsettling for many American workers. In addition to job cuts, service workers must now also contend with the enhanced power of highly mobile, increasingly unregulated global corporations to bargain down U.S. wages and working conditions by threatening to move jobs elsewhere.

According to McKinsey and Company, a consulting firm that helps businesses develop offshore operations, U.S. companies make up about 70 percent of the global outsourcing market. Their top destination in the developing world is currently India, where domestic subcontractors perform a range of services for the U.S. market. At the low-skill end, Indian workers earn \$1 or less per hour to handle customer service calls for firms like Earthlink and Travelocity. Among the higher-skill workers are Indian computer programmers, who earn about one-tenth the pay of their U.S. counterparts to write code for multinational corporations like Citigroup. Given a lack of other economic opportunities, Indian workers are often eager to secure new jobs catering to the U.S. market. However, there is also a nagging fear that these jobs may evaporate as soon as companies can find lower costs elsewhere.

China, of course, looms on the horizon. It is already the second-biggest developing-country draw for service work, offering rock-bottom wages and an official ban on basic union rights. Though it lacks India’s English-speaking advantage, this may not be the case forever, as Beijing is heavily promoting English-language education. Mexico’s experience in competing with China over manufacturing jobs could foreshadow events to come. Although employment in Mexico’s border export zone more than doubled after the implementation of the North American Free Trade Agreement (NAFTA) in 1994, the country has in recent years lost several hundred thousand of these jobs, partly in economic flight to lower-wage China. India has even lost some foreign manufacturing jobs to China.

Public pressure has galvanized U.S. state and federal legislators to introduce a flurry of bills to curb outsourcing, primarily by requiring that government contract work not be performed overseas. However, there is stiff resistance from the corporate lobby, such as the new Coalition for Economic Growth and American Jobs, which represents some 200 trade groups, including the U.S. Chamber of Commerce and the Information Technology Association of America. These and other pro-outsourcing groups argue that the practice is good for U.S. workers, because it lowers the cost of services for U.S. consumers and enhances the overall competitiveness of U.S. companies. Another common claim is that recent job losses are due to productivity gains, not outsourcing. However, because workers are facing a “jobless” recovery and see few personal benefits from enhanced productivity, these arguments convince very few.

One reflection of public opinion is that concerns about U.S. trade policy have spread up the income ladder. Lower- and middle-class workers have been consistently skeptical of U.S. trade policies, but a February 2004 University of Maryland poll showed that even among Americans earning over \$100,000 a year, support for actively promoting more “free trade” has dropped from 57 percent in 1999 to 28 percent in 2004.

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Problems with Current U.S. Policy

As they vie for votes in layoff-ridden swing states, both presidential candidates are offering solutions to the prevailing American angst about trade and outsourcing. Railing against “Benedict Arnold” companies, Sen. John Kerry has vowed to eliminate government incentives for outsourcing. For example, he would place conditions on most government contracts to require that the work be performed in the United States. He would also eliminate a tax break that currently allows U.S. businesses to defer tax payments on income earned abroad, and he proposes to use the resulting revenue to lower the overall corporate tax rate from 35 to 33.25 percent. Similarly, Kerry would offer incentives to encourage transnational corporations to repatriate earnings and would then channel these revenues into an employer tax credit for new hires. Regarding trade, Kerry has vowed to include stronger labor and environmental protections in future trade pacts and to review all existing agreements.

The Bush administration has delivered mixed messages regarding outsourcing. Two prominent officials have publicly endorsed the practice—Treasury Secretary John Snow and Gregory Mankiw, chairman of the Council of Economic Advisers. Both have argued that foreign outsourcing of service jobs is good for the American economy, because it helps companies become more efficient. Meanwhile, President Bush has sought to distance himself from such statements and instead to focus public attention on his administration’s new “21st Century” jobs plan. Bush argues that the real driving forces behind outsourcing are “frivolous” lawsuits, excessive regulation, and high taxes. He also claims that NAFTA and other trade agreements have been good for U.S. workers, and he promises that by breaking down even more trade barriers his policies will boost export-related jobs. “The best product on any shelf anywhere in the world says, ‘Made in the USA,’” Bush told an audience of women entrepreneurs in Cleveland.

But the Bush administration’s jobs plan ignores the historical record and thus misdiagnoses the problem. Government figures show that U.S. employment for American multinational corporations grew only 25 percent between 1982 and 2001, while employment at their overseas affiliates increased 47 percent. (These figures likely underestimate foreign expansion, because they do not include information on employment through subcontractors, data the U.S. government does not require businesses to report). This period of rapid overseas expansion has coincided with increased trade and investment liberalization and a declining corporate tax burden. U.S. employers are leaders in outsourcing, even though their share of the national tax bill is considerably lower than the average for employers in other industrial nations.

Bush’s claim that companies are fleeing “Big Government” is also dubious. McKinsey and Company claims that U.S. corporations have led the outsourcing trend not to escape burdensome regulations, but because the relatively unregulated U.S. labor market facilitates sending jobs abroad. McKinsey, a pro-outsourcing consulting firm, points out that compared to most European counterparts, the United States has “liberal employment and labor laws that allow companies greater flexibility in reassigning tasks and eliminating jobs.”

Kerry’s early jobs plan is encouraging, but it addresses only one side of the issue. His proposal to end taxpayer subsidies for outsourcing, whether through government contracting or tax breaks, is long overdue. Citizens should not have to pay higher taxes to subsidize the evaporation of their jobs. To ensure effectiveness, any reforms must be carefully crafted to prevent potential loopholes. More effort will also be needed to address the threat posed by existing international agreements to domestic legislation that requires public contract work to be performed in the United States. For example, under World Trade Organization rules, the Government Procurement Agreement bans governments from favoring domestic firms in procurement contracts. Although only 25 countries have signed the agreement thus far, plans are under way to expand its scope and incorporate similar rules in other trade pacts.

Kerry’s primary focus on domestic measures will have only a modest impact on the jobs

issue, because these policies cannot make up for the extreme gap in labor costs, which is the primary driving force behind outsourcing. McKinsey estimates that global pay gaps result in a net cost savings for outsourcers of at least 45-55 percent (after accounting for higher infrastructure and other costs). If this is true, figures in a 2003 University of California, Berkeley study suggest that companies could save around \$300 billion a year if they outsourced all of the estimated 14 million U.S.

service jobs considered feasible to transfer overseas.

Kerry’s promises to change U.S. trade policy are also a step in the right direction. If there were effective international mechanisms to strengthen labor rights enforcement, developing-country workers would have a better chance of obtaining fair wages. Research commissioned by the AFL-CIO indicates that labor rights violations in China artificially depress wages by 47-86 percent and that if the country were to respect basic internationally recognized labor rights, wages would likely increase 90 to 595 percent. However, the goal of strengthening labor rights protections should be pursued as part of a broader strategy to uplift conditions generally in poorer countries. Without overall economic improvements, developing-country governments will continue to face strong pressure to attract foreign investment by offering lax labor rights enforcement, thereby undermining efforts to maintain high standards in the richer countries.

Key Problems

- The Bush administration argues that tax cuts and deregulation will prevent U.S. firms from exporting jobs, even though U.S. regulations are weaker and corporate tax rates are lower than those in most other industrial nations.
 - Senator Kerry’s proposals to end tax subsidies are positive but are unlikely to significantly reduce the lure of cheap labor.
 - Kerry’s promises to change trade policy and incorporate labor rights are important, but they would be more effective as part of a broader development strategy.
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Toward a New Foreign Policy

The overall goal of U.S. policy on outsourcing should be to attack the factors that make workers—in the U.S. as well as around the world—vulnerable to exploitation by increasingly mobile and unregulated global corporations. The approach needs to recognize that raising standards overseas is vital to retaining stable and substantial jobs at home. This requires a multifaceted response encompassing changes in domestic tax, procurement and labor laws as well as in multilateral trade, finance and aid policies.

Key Recommendations

- The U.S. government should ensure that tax, government procurement and subsidy policies are instruments for supporting good U.S. jobs.
- Washington should promote internationally recognized labor rights and an end to trade and finance policies that contribute to the destruction of small-scale agriculture and the privatization of social services.
- The U.S. should work with other rich nations to advance more effective debt reduction and development aid mechanisms.

Moreover, the U.S. government should ensure that U.S. authorities, as well as their counterparts around the world, have the right to use tax and procurement policies as instruments to support social goals without being undermined by international trade agreements.

The domestic policy response should also involve labor law reforms that reduce current obstacles to union organizing and that beef up rules related to laying off workers. Most European countries require that corporations guarantee higher severance pay based on years of service, which substantially raises the cost of moving jobs. Many European countries also oblige companies that are planning to close an operation to consult with unions and sometimes to negotiate over the decision. By contrast, under U.S. law, unions may only bargain over the effects of a closure. Thus, although European countries also experience outsourcing-related job loss, the practice is not as advanced as in the United States.

However, domestic measures, while significant, do not address the biggest incentive for outsourcing—extreme wage gaps. Tackling this problem will require a long-term commitment to supporting sustainable economic activity in poor countries and should focus on the factors that make workers around the world vulnerable to exploitation by global companies.

One of these factors is lax enforcement of internationally recognized labor rights, which artificially depresses wages. U.S. policy-

makers must learn from the failure of NAFTA's weak labor rights mechanism and should develop a better model. The Hemispheric Social Alliance has proposed involving the International Labor Organization in monitoring compliance and investigating complaints related to rights violations. If necessary, assistance would be provided to help countries achieve compliance. Only if this approach was unsuccessful would sanctions be applied, and if the perpetrator was a specific company, the punishments would be targeted at the company rather than at the host government.

Any labor rights initiative, however, should be integrated within a broader strategy toward poorer nations. Other factors that make workers vulnerable are high unemployment and poverty. Although national governments are not without responsibility for these problems, international financial institutions and trade agreements have played an exacerbating role. For example, the World Bank, the International Monetary Fund and the World Trade Organization all threaten the livelihoods of tens of millions of farmers by pressuring poor-country governments to eliminate tariffs and agricultural subsidies. Likewise, privatization supported by these international financial institutions has often resulted in mass layoffs and weakened social services. These multilateral agencies should instead join governments in promoting "global green deal" policies that stimulate stable and substantial employment while protecting the environment.

Regarding trade, Washington should withdraw its support for rules—such as in Chapter 11 of NAFTA—that grant excessive protection to U.S. investors against public interest laws and other host government actions that diminish profits. Such trade rules undermine democracy and encourage U.S. firms to shift jobs overseas.

To enhance this new and broader strategy toward poorer nations, the U.S. government should advocate for stronger international mechanisms to transfer resources from richer to poorer countries. Where appropriate, this would include debt reduction or cancellation. Washington could also promote the adoption of international taxes on both foreign exchange transactions and arms sales to generate revenues for development purposes. The U.S. must also revamp its development aid policies to emphasize anti-poverty measures, healthy communities and a clean environment rather than handouts to U.S. corporations like Halliburton and Bechtel.

In short, a comprehensive response to corporate outsourcing requires a sea change in the outlook of both the U.S. public and its politicians toward America's role in the world. Just as Americans are less secure when much of the world is plagued by extreme poverty, inequality and instability, worker exploitation overseas translates into exploited workers and less secure jobs at home. The electoral debate over outsourcing offers an opportunity to create a new policy approach that combines solidarity with self-interest in a whole-scale effort to benefit the entire world.

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Sources for More Information

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