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Sending Jobs Offshore from the United States: What are the Consequences?

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In the United States, the Fourth of July is usually a day of celebration. But the date has a darker meaning for families of more than a thousand workers in central New York. That is because Independence Day, 2004, was when Carrier Corporation halted its Syracuse-area production of cooling equipment, and 1,200 hourly and salaried employees watched their jobs move to Asia (Fay 2005). Carrier workers are not alone. In July 2005, U.S. manufacturing employment totaled 14.3 million, down three million since July 2000. That is a loss of about 20 percent of America's manufacturing jobs in just a few years.

Of course, not all of these jobs moved outside the U.S. But competition from lower-paid foreign workers is a major cause of the decline, according to the Congressional Budget Office (2004). Josh Bivens, an economist at the Economic Policy Institute in Washington, DC, estimates that as many as two-thirds of the domestic manufacturing jobs lost since the mid-1990s can be blamed on the substitution of imports for goods that had been produced in the U.S. (Bivens 2004).

In short, U.S. consumers are substituting goods produced by foreign labor for goods produced by their fellow citizens. And often this occurs because U.S.-based multinationals close U.S. operations and either relocate their production facilities overseas or contract with foreign-based producers. This sounds like »offshoring«, and it certainly is. But it has been happening since the 1960s; in fact, U.S. manufacturing employment has been falling since 1979. Offshoring, however, has appeared more recently in the lexicon of economists, policymakers, and journalists. This article explains the term's more recent appearance and often very limited meaning. It also explores the magnitude of the phenomenon, identifies the jobs affected or »at risk«, describes the impact on enterprises, workers, and communities, and recommends some steps that could help policymakers achieve a more prosperous economy in the face of this trend.

This is Progress?

A brief historical sketch will set the stage for a closer look at the current wave of offshoring. By most accounts, manufacturing jobs represented the Old Economy, and could not or should not be saved. These jobs were heavily blue-collar and unionized, did not require more than a high-school diploma, got your hands dirty, and, according to the conventional wisdom, paid workers »too much«. When the jobs disappeared, workers were told to pull themselves up by their bootstraps and join the New Economy: learn to use – or even program – computers, and jump on the service-economy bandwagon. More than anything else, this transition was considered a sign of economic progress.

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I recall that in the early 1990s, Buffalo, New York, landed a call center employing a few hundred people. Local leaders touted that center's customer-service phone jobs as a sign that western New York was part of the high-tech economy.

But enthusiasm over the New Economy never really made it into the new millennium. The technology-driven investment boom went bust, as did the dot.com frenzy – and the stock market. Call-center workers were just a fraction of the many service-sector employees suddenly finding themselves out of work or at risk of unemployment as jobs were relocated to places such as the Caribbean and China.

It was not so easy to call this »progress« any longer, and the term »offshoring« began appearing in news accounts and academic papers. Moreover, although offshoring can be applied to both blue-collar and white-collar jobs, it has become most closely associated with the substitution of foreign labor in white-collar, service jobs. In short, offshoring (also called international outsourcing) is used most often to describe the loss of positions previously considered insulated from foreign competition.

»At Risk« Jobs Run the Gamut

Who is being affected by services offshoring? The federal government does not collect reliable statistics. Some private sector researchers estimate that services offshoring has cost the U.S. a half-million jobs over the past three years; others suggest that close to a half-million jobs were lost in 2004 alone. The consulting firm Forrester Research predicts that 830,000 U.S. service jobs will be lost to offshoring this year – and it projects that a total of 3.4 million will be lost from this sector by 2015 (Associated Press 2004).

Assuming the Forester projection for 2005 proves accurate, that is still less than six percent of the workers who involuntarily lose their jobs each year. Moreover, the U.S. economy ended 2004 with a total of 1.7 million jobs more than existed at the end of 2003; the economy has not lost its ability to create jobs.

Nevertheless, job loss can be traumatic, and the creation of new jobs does not always benefit those who see their positions go offshore. So, who in the service sector is at risk to lose their job to offshoring? A recent study by economists at the University of California at Berkeley concludes that 14 million Americans are in jobs that are at risk, which means the job of one out of every ten nonagricultural workers is threatened. Their estimate is based on a combination of historical data, announced business plans, and job attributes (Bardhan/Kroll 2003[1]).

Among the most »at-risk« occupations mentioned by the Berkeley economists are the following:

- office and administrative support jobs, which include about two-dozen occupations such as computer operator, switchboard operator, data enterer, and a range of office clerks;

1 With data updated in 2005.

- many business and financial occupations, including financial analyst, credit card and insurance-claim processor, tax preparer, accountant, and payroll record keeper;
- paralegals, legal assistants, and medical workers, including x-ray readers and medical transcriptionists;
- graphic designers, technical writers, and computer and math professionals (such as programmers, software engineers, statisticians and actuaries).

These economists also offer another glimpse at what jobs are at risk. They report a saying among companies providing outsourcing services to businesses: »Any job that involves mostly sitting at a desk, talking on the phone, and working on a computer is under potential threat.« (Bardhan / Kroll 2003: 4)

That statement lends support to a point buried in a 2003 study by the McKinsey Global Institute (MGI), the research arm of the McKinsey & Company consulting group. The McKinsey study suggests that up to 30 percent of the economy's jobs can be offshored (MGI 2003: 9). The study also makes it clear that work currently offshored runs the gamut (MGI 2003: 6):

- back-office processing of documents and data;
- customer contact jobs, such as customer service and telemarketing;
- corporate services, such as finance, accounting, human resources and information-technology support;
- knowledge services and decision analysis, such as research services, portfolio analysis, risk management and credit underwriting;
- and even path-breaking research and development, such as engineering, design, and testing of new products.

Sixty-Four Cents an Hour

The prime motivation behind offshoring is the desire to reduce labor costs. There is a huge difference between the U.S. and developing countries when it comes to compensation of workers with equivalent skills. For example, a U.S.-based software developer who costs a company $ 60 an hour can be replaced by an Indian developer with the same skills for $ 6 an hour (MGI 2003: 6). A programmer in the Philippines who is paid $ 1.50 an hour can replace a U.S.-based computer programmer who costs $ 10 an hour (Outsource Philippines 2005). And if we include manufacturing in our definition of offshoring, then a U.S.-based factory worker hired for $ 21 an hour can be replaced by a Chinese factory worker who is paid 64 cents an hour. In addition to the wage difference, employers believe that workers are motivated to be dependable and highly productive in nations to which jobs are offshored (Coy 2004).

The main reason offshoring is happening now is because it can. Innovations in information technology have given us personal computers, the ability to computerize and digitize most business services, and the opportunity to cheaply connect operations around the globe by means of international telecommunications. Toss into the mix sagging profits

from the tech bust, and a fear that competitors are already doing it, and there is no surprise companies have been rushing to relocate jobs.

According to McKinsey, the top destinations for services offshoring have been Ireland, India, Israel, and Canada. Other destinations include China, Eastern Europe, the Philippines, Australia, South Africa, Russia, and Thailand. A major factor is access to English-speaking workers; 70 percent of worldwide services offshoring is done by U.S.-based businesses (MGI 2003).

Winners and Losers

What are the consequences of offshoring? According to mainstream U.S. economists, offshoring is just another form of international trade, which means they see it as benefiting America and its trading partners. Dislocations are acknowledged, but conventional economists stress that »the economy overall benefits« (Mankiw 2004a, 2004b). American heterodox economists and labor unions, meanwhile, draw attention to the dislocations, and emphasize that negative effects (job loss, a lower standard of living, etc.) may be felt by many more than those who watch their jobs disappear overseas. Indeed, such economists argue a »crisis of demand« could be triggered, which might result in a deep recession and a prolonged period of weak economic performance. Even worse, offshoring can mean the loss of jobs and production capabilities vital to national defense (Public Citizen 2005, Connell 2005, Parks 2004, Sleigh et al. 2004).

Offshoring certainly produces winners and losers. Big winners are stockholders and consumers. For every dollar of services offshored, McKinsey estimates that a company's shareholders and/or consumers gain 62 cents in the form of higher profits and/or lower prices. Some of the gain in profits might even lead to further job creation in the U.S., and there is evidence that many U.S.-based companies continue to create jobs here even while they offshore others (Slaughter 2004).

For enterprises, offshoring means substantially lower production costs. When companies offshore jobs, the huge gap between U.S. and overseas wages is offset somewhat by higher telecommunications costs and the expenses associated with coordinating global operations. Still, researchers estimate that even when these offsetting costs are considered, companies save at least 50 percent over U.S. production. In fact, the savings are often increased to 70 percent by means of a reorganization of the work process (MGI 2003: 2).

Here is a specific offshoring example: BellSouth Corporation plans to send the jobs of about 650 computer programmers and software maintenance technicians to India by 2007, for an estimated five-year savings of $ 275 million. No wonder India's National Association of Software Companies reports that the number of Indian workers producing software for export to the U.S. increased by over 100,000 between 2000 and 2004. Over the same period, U.S. software employment fell by almost 200,000 jobs (Economic Policy Institute 2005).

The clearest gain from offshoring is found in corporate profits. Two years into the current recovery, which began in late 2001, the profit share of national income grew 33 percent

(on a pretax basis), compared with only a three percent gain in the recovery of 1992–1993. Worker compensation, however, was *down* four percent – which, according to economists at the Brookings Institution, represents a steeper decline than in any previous recovery of the last 40 years (Brainard/Litan 2005: 11). The gain in corporate profits relative to wages translates into a substantial redistribution of income. That is because half of the households in America hold no stock in any form, including mutual funds and 401(k)-style pension plans. In fact, half of the workers with 401(k) plans have less than $ 10,000 in their accounts (Gleckman 2005). At the same time, the top 20 percent of the nation's stockholders own almost 95 percent of all stocks (Mishel et al. 2005: 277 f.).

Big Losers

Workers who watch their job offshored are the big losers. After losing their job, sixty percent of service workers reported taking a pay cut when becoming reemployed, according to U.S. Department of Labor surveys conducted between 1979 and 1999. One out of every five of those re-employed reported taking a pay cut of 30 percent or more. Even worse, 30 percent of service workers losing their job to offshoring were unemployed for an extended period, often a year or more. Losses from offshoring are even more substantial among manufacturing workers (Kletzer 2001: 31 f.).

Long periods of unemployment and large declines in income are likely to persist among those affected by offshoring. Of the dozen occupations projected by the U.S. Department of Labor to produce the most jobs in the nation by 2008, half of them pay poverty wages. These high-growth jobs include janitors, cashiers, and home health aides.

Of course, workers who do not lose their jobs might gain from slower growth in product prices (it is possible that offshoring might restrain inflation by a couple tenths of one percent), but there are also negative effects on these workers. For example, offshoring means a larger portion of payroll taxes has to be paid out in the form of unemployment benefits; that leaves less tax dollars for other public initiatives. Further, since most workers losing jobs to offshoring take a pay cut when rehired, everyone is affected by the reduction in consumer purchasing power. The continuously employed also lose because the threat of having their own jobs outsourced means they settle for lower wage increases – and may even accept a pay cut or benefit concessions.

Offshoring of goods and services has other negative consequences. At the national level, for example, offshoring adds to the U.S. trade deficit, which was a record $ 620 billion last year. The largest imbalance was with China, from which America imported $ 162 billion in goods and services more than it exported. At the community level, offshoring has ripple effects. For example, Robeson County, in southeastern North Carolina, lost 8,700 manufacturing jobs to international trade between 1993 and 2003. As those employment losses rippled through the community, another 10,000 jobs were lost according to a recent study (Hossfeld/Legerton 2004). Another example is Galesburg, Illinois, a small city in the western part of that state. Last September, it lost its largest employer, as Maytag Corporation moved a refrigerator plant and its 1,600 jobs to Mexico. A Western Illinois University

study estimates the total job losses in the area will be 4,200 (Rural Economic Technical Assistance Center 2003). These ripple effects run through two main channels. First, when jobs are offshored, suppliers often reduce their workforces too. Second, households affected by job loss tend to spend less on local goods and services – so all establishments feel the pinch, including restaurants, the local post office, the hardware store, the neighborhood bank, and so on. Even local charities are affected. At the family level, meanwhile, job loss has long been shown to have economic, social, medical, and psychological costs. For example, unemployment is associated with increased rates of suicide, homicide, mental hospital admission rates, and alcohol abuse.

Achieving a More Prosperous Economy

There are at least three constructive steps U.S. policymakers can take in the face of offshoring. First, they can ease the dislocation faced by workers who lose their jobs. Today, there are training, healthcare, and income benefits for manufacturing workers who lose jobs to foreign trade. Service workers, however, are not eligible for such benefits. Trade Adjustment Assistance needs to be extended to service workers.

Second, policymakers can keep the overall economy running hot so the unemployment rate is as low as possible. In the year 2000, for example, the unemployment rate was four percent. Last year, it was 5.5 percent, and it was even higher in 2002 and 2003. More budget discipline would help by allowing the Federal Reserve to keep interest rates low. (Recent tax cuts, tilted toward the wealthy, have produced much red ink without adding much consumer demand.) Low overall unemployment means higher national output, greater demand by households, and a smoother transition to re-employment for job seekers (Bernstein/Baker 2003).

Finally, companies in the United States should be encouraged to compete by treating their domestic workers as a source of innovation, high productivity, and product quality, rather than to compete by viewing employees as a cost to be minimized. There are two routes to competitiveness. When firms compete by focusing on innovation, productivity and quality, they take the »high road« – and there are benefits for workers, shareholders and consumers; when firms search the globe for low wages and compete by using cheap labor to undercut each other, they set out on a »low road« that sets up a »race to the bottom«. At first, it is just displaced workers who suffer from the »low road« approach, but eventually communities and corporate profits can be hurt too, as purchasing power stalls. Policymakers could encourage more companies to take the high road by making more effective existing programs such as the Manufacturing Extension Partnership (based loosely on the national agricultural extension concept) and by expanding tax incentives for employers who support workers continuing education and training.

Of course, it won't be easy to achieve a high-employment economy in which companies choose the competitive high road over the low road, and in which displaced workers are given a helping hand. But achieving such an economy would certainly give Americans more reason to celebrate on Independence Day.

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