

The Outcry over Outsourcing: Economy will Benefit in Long Run

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Article:

From time to time, a new catch-phrase dominates the public debate on economics, and usually it describes something that scares us. At one point during the 1990s, it seemed that all we heard about was “down-sizing.” The story was that companies were getting smaller and shedding workers, and the fear was that this was really bad news for the economy.

Of course, there was actually very little bad news for the economy in the 1990s. From 1991 to 2000, the economy added over 23 million jobs, as employment grew faster than the population. In spite of what the pundits said about down-sizing, the employment picture wasn't bad outside of certain industries like textiles.

But these days bad economic news is easier to come by. Even though long-awaited gains in employment are just around the corner, the economic recovery is proceeding slowly, and people are still gloomy about jobs and job security. It is in this economic environment that we now have a new catch-phrase: “out-sourcing.”

Once again, the new catch-phrase is scary. The pundits tell us that out-sourcing is the primary cause of job losses and will transform our economy. One view holds that it will cause the “hollowing out” of America, as all of our jobs go overseas.

The abhorrence of out-sourcing knows no political boundaries. The reliably liberal *News & Record* has editorialized against it. Democratic presidential candidate Sen. John Kerry is using the term to take all sorts of jabs at President Bush. He said recently that he will “out-source” the president's “unaffordable tax cut for the wealthiest Americans.”

Conservative supply-side economist Paul Craig Roberts disagrees with liberals about tax cuts, but he agrees about out-sourcing. He claimed recently that it will cause the United States to become “a Third World country in 20 years.” When the president's chief economic adviser, Gregory Mankiw, told Congress that out-sourcing is good for the economy, even Republican politicians criticized him. One called for his resignation.

The first thing we need to do is to stop hyperventilating about out-sourcing and try to understand what it is. Once we do, we'll see that out-sourcing does indeed present a challenge to American workers. However, it's little different than the challenges Americans have faced for decades, and in any case most of our concerns about it will disappear when employment rebounds.

What is out-sourcing? Simply put, it is the process of contracting with outside companies to produce goods or perform services which were once done, or which could be done, in-house.

Virtually every business has to decide whether or not to out-source. Should sales trips be arranged by an internal travel office or by an outside travel-services firm? Should a website developer be on staff, or should a website design firm be hired? Should cushion springs be made on-site, or bought from a supplier? These are all out-sourcing questions, and they are fundamental to the way businesses are run.

Most out-sourcing is completely domestic, with the outside company located nearby or perhaps in another part of the country. Of course, no one is particularly bothered by that. The big concern appears to be a variant called “off-shoring,” which is when the outside company is located in another country. Off-shoring also refers to situations in which there is no out-sourcing *per se*, such as when the foreign workers are employees of the original company.

Both out-sourcing and off-shoring have been part of manufacturing for years. Manufacturing companies have become less vertically integrated and more dependent on suppliers. It used to be that automobile makers produced nearly everything that went in a car, from the seats to the radio. Now other companies make many of those items and sell them to Detroit. In some industries, “manufacturers” out-source almost all of the actual manufacturing. For example, Dell doesn’t actually make much of what goes inside its computer boxes. Most Americans are basically okay with all this, because it holds down the prices of both cars and computers.

But all of a sudden, everyone got really upset about off-shoring, and it appears to have happened once it became a factor in the service sector. Perhaps pundits and politicians are more likely to know and care about service workers than manufacturing workers. Perhaps it’s just a matter of numbers. Fewer than 12 percent of Americans workers are employed in manufacturing, while roughly five of every six are in services.

How important is off-shoring? It’s important to some companies, but it’s not a big piece of the overall economy. A frequently cited study by the consulting firm Forrester Research estimates that 3.3 million service-industry jobs will be off-shored by 2015. That sounds like a lot of jobs, and some have used this figure as evidence of the horrors of off-shoring.

However, that 3.3 million figure is actually small potatoes when viewed in the context of the tremendous job-churning that is always going on in the American economy. For example, in 1999 alone, 33 million jobs were lost, which is ten times the multiple-year job loss predicted by Forrester Research. The 33 million figure includes all workers, but remember that the vast majority of us are service workers.

It should also be noted that in 1999, 35.6 million jobs were created, which more than offset the jobs lost. To be sure, job losses have exceeded job gains since 2001, but that’s a function of the business cycle and will soon reverse itself.

Much is made of accounts of software engineers losing their jobs and the work being reassigned to lower-paid engineers in India. In a sense, we’re looking at these jobs in the wrong way. We classify them as information-technology jobs, but many of them involve relatively routine back-office work, like code-writing. They’re actually second cousins of the assembly-line jobs lost in manufacturing. IT jobs that require an in-depth knowledge of business processes are going nowhere.

A recent report by the U.S. Bureau of Labor Statistics lists the occupations expected to grow the most between 2002 and 2012. Among the ten fastest growing occupations are network-communications analysts and software engineers. It’s certainly hard to square that prediction with a belief that off-shoring is ripping the heart out of the IT sector.

The American labor market can handle whatever out-sourcing and off-shoring have to throw at it. This is not to imply that there will be no pain among workers. But the pain is essentially no different than what is always being caused by job-churning, changing demand, and changing technology. There is nothing new under the sun, even with out-sourcing.

Are out-sourcing and off-shoring good for the American economy? The president’s economic advisor Gregory Mankiw thinks they are, as does Federal Reserve chairman Alan Greenspan. Both acknowledge that the benefits do not necessarily accrue in the short run. In remarks to Congress recently, Greenspan highlighted the role of improved education and training in meeting the long-run challenges presented by off-shoring.

Far from costing the U.S. jobs in the long run, Greenspan said that the openness of our economy has encouraged job growth. One rarely hears about all the jobs created in the U.S. by foreign companies that want to be closer to the consumers they serve. Neither does one often hear that the U.S. is a major exporter of services, and that low-wage service providers in foreign countries need high-margin American equipment and services in order to operate.

According to Greenspan, what *would* cost us jobs are measures designed to restrict the ability of businesses to out-source: “Protectionism will do little to create jobs, and if foreigners retaliate, we will surely lose jobs.” In spite of long-standing and widely distributed gains from trade, Americans are incredibly uncomfortable these days with their role in the international economy. Concerns over out-sourcing are just the latest version of this discomfort. It’s easier to see the costs of out-sourcing than its benefits. But the benefits outweigh the costs, and it’s time that we quit worrying about such distractions as out-sourcing and start addressing the real issues, such as improving worker education and training.

But wait, I forgot. It’s an election year. The real issues rarely get addressed in an election year.