

Outsourcing – will your job move to Bangalore?

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AED Economics



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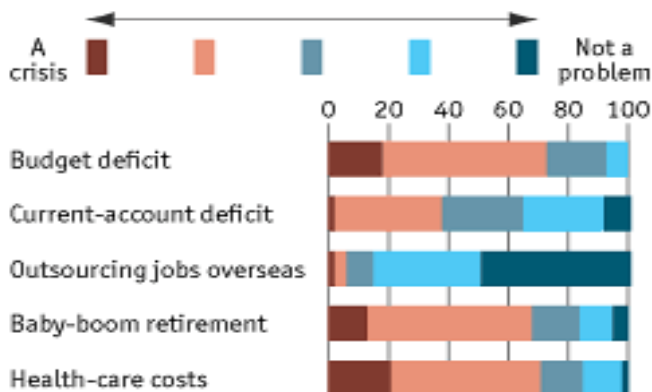
- Hot-button issue in election
- Very different views of outsourcing:
 - “...it’s something that we should realize is probably a plus for the economy in the long run” (Gregory Mankiw, Chair of CEA)
 - “Outsourcing is a critical issue for my district...Gov. Taft needs to step up to the plate and help prevent the job losses Ohio is experiencing everyday” (Robert Hagan, D Youngstown)



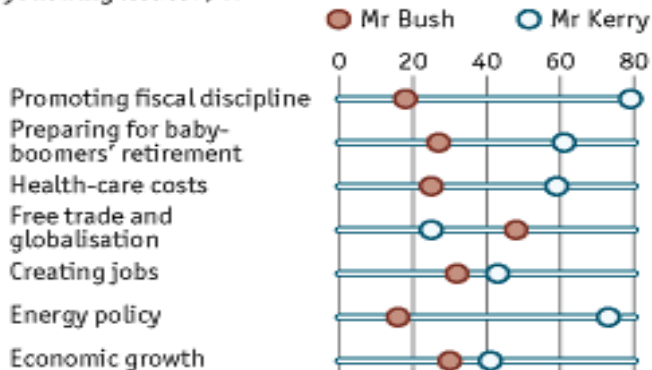
Economists and outsourcing

Low marks for the president

Rate the following challenges facing the US economy, %

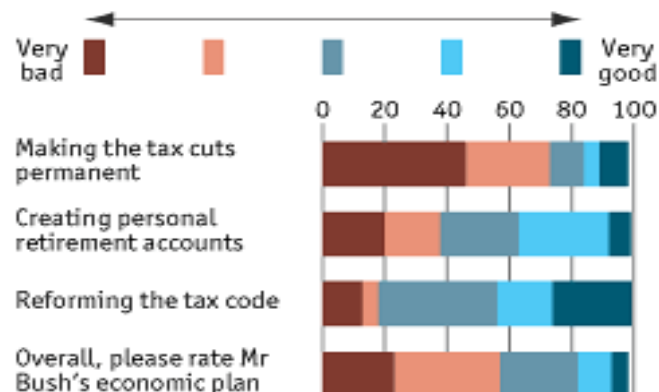


Which candidate has the better policies on the following issues?, %

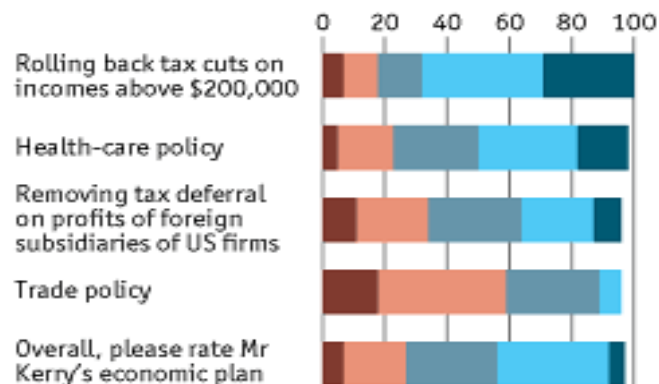


Source: *The Economist*

Rate the following components of Mr Bush's campaign agenda, %



...and Mr Kerry's campaign agenda, %



The polling of 56 academic economists took place during September

What is outsourcing?

- **Some confusion over concept**
- **Procuring of *service* or *material* inputs by a firm from a foreign source - *offshoring***
- **Origin - contracting out of design work in UK auto industry to Germany in 1970s**
- **Focus now on service outsourcing to low-wage countries such as India**

Outsourcing: by whom, where to and what jobs?

- **Mainly US and UK-based firms**
- **Predominantly to English-speaking countries, e.g., India**
- **Back-office services (accounting, payroll and personnel), telephone call centers, and computer programming**
- **Examples in Ohio:**
 - **LexisNexis (Dayton) IT jobs**
 - **Chiquita (Cincinnati) IT jobs**
 - **Procter & Gamble (Cincinnati) IT and back-office jobs**
 - **MCI (Niles) telephone call center**

What causes outsourcing?

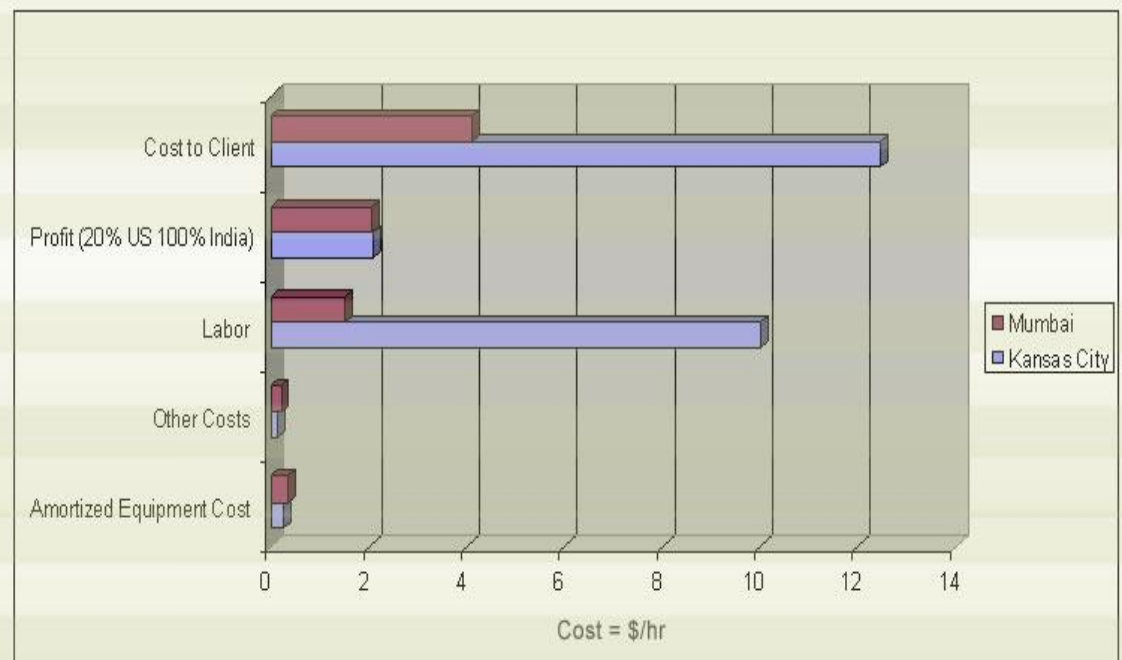
- **Lower labor costs overseas**
- **Increase in educated workers overseas**
- **Technological advances in computers and telecommunications**
- **Deregulation and trade liberalization in services sector**

Call center costs in India



Table 1.

Cost Comparison between a Call Center Operated in Mumbai, India and Kansas City, 2002.



Source: Authors' estimates

Most vulnerable jobs?

- Labor-intensive – *call-centers*
- Information-based – *accounting*
- Routine – *customer inquiries*
- High-transparency – *financial analysis*

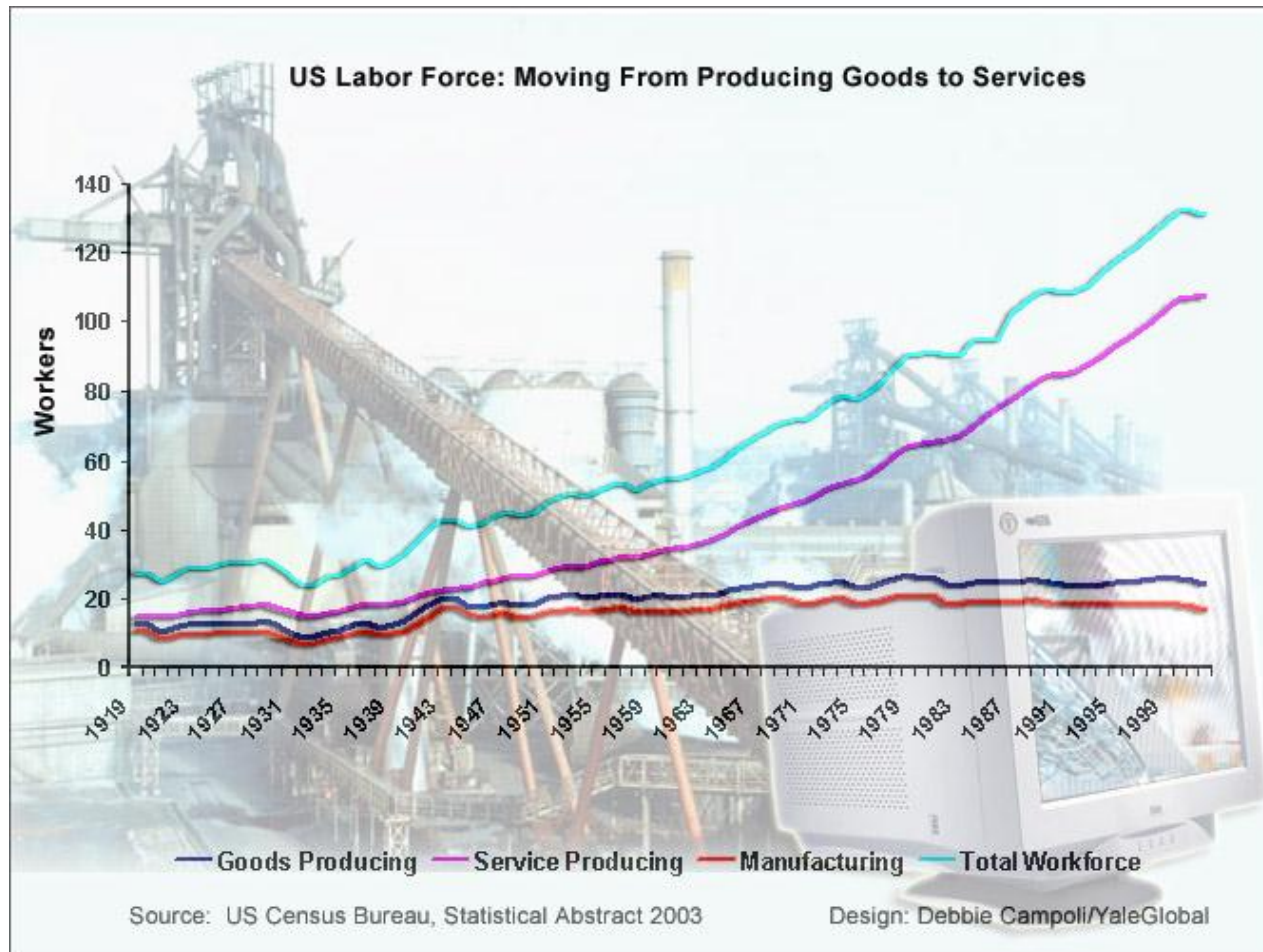
How many US service jobs?

- Pace increased from 103,000 in 2000 to 315,000 in 2003 (McCarthy, Forrester Research, 2004)
- 3.4 million service jobs expected to be lost by 2015, with a wage loss of \$151 billion (McCarthy, op. cit.)
- Expected annual job losses accounts for 1% of 30 million jobs “churned” each year

Why the concern?

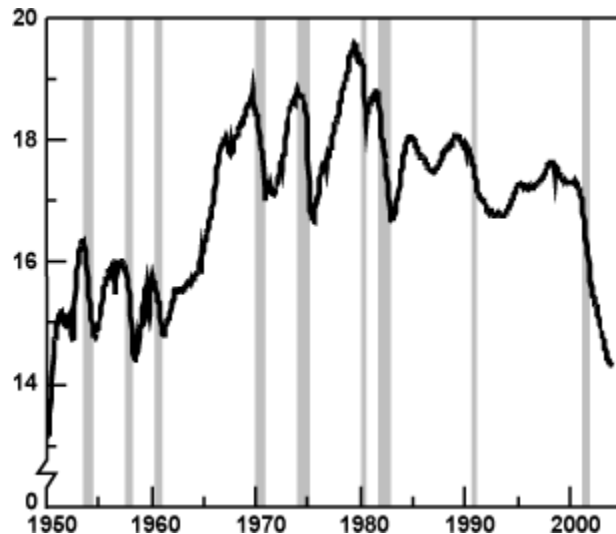
- **Employment in services sector has outgrown that in manufacturing**
- **Service sector previously impervious to international competition**
- **Pace of outsourcing will be swift given modern communication technology**
- **Concerns about a “jobless” recovery**

Structure of US Labor Force

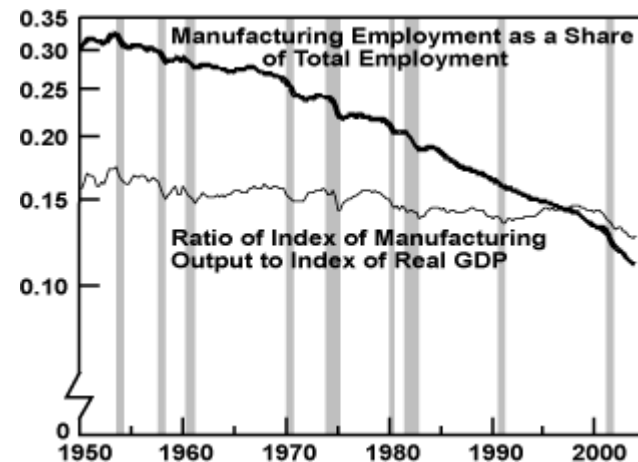


Decline in US manufacturing employment

**Manufacturing Employment
(Millions of jobs)**



**Output and Employment in the
Manufacturing Sector (Log scale)**



Sources: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics; Department of Commerce, Bureau of Economic Analysis.

Note: The vertical bars indicate periods of recession as defined by the National Bureau of Economic Research.

Why the decline in manufacturing employment?

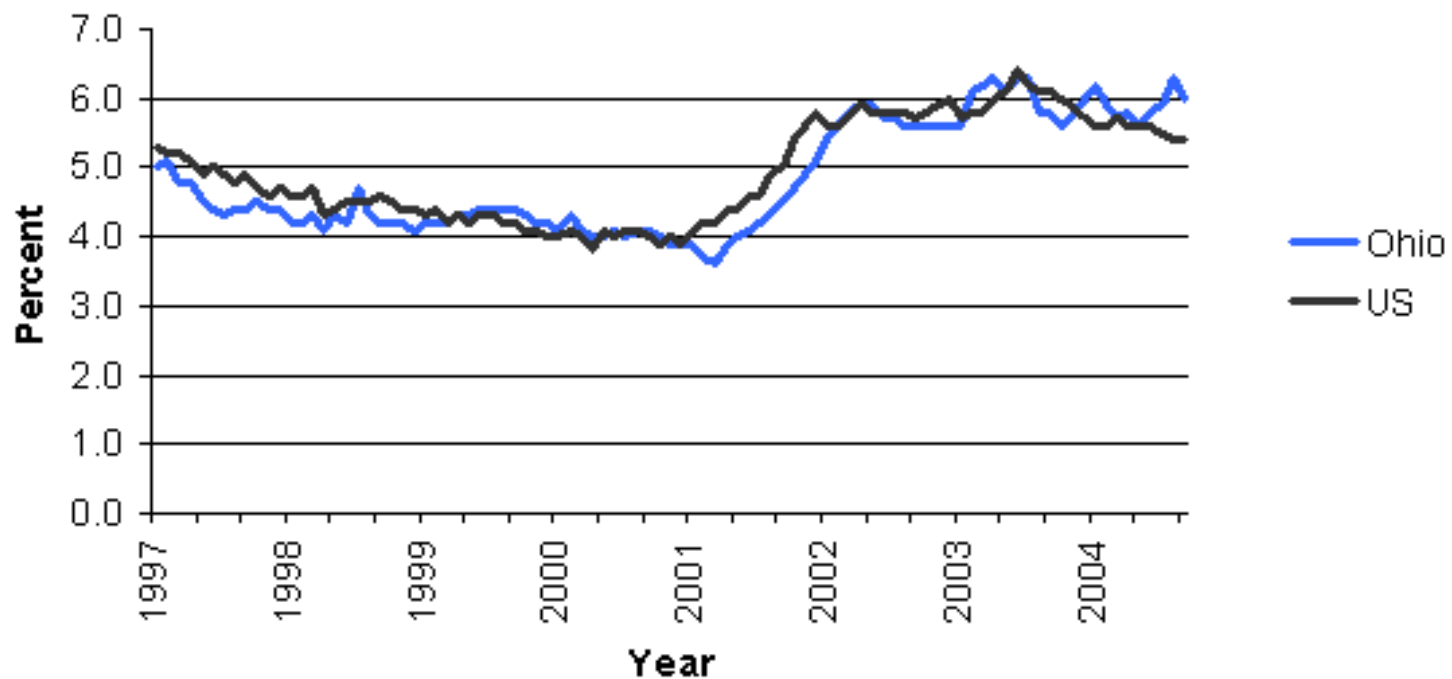
- Shift in demand away from manufactured goods to service goods
- Increased labor productivity (40% of job losses)
- Structure of US exports has shifted from products using low-skilled labor to those using high-skilled labor
- 1992-2004, 1.3 million jobs lost in US due to import competition (Economy.com) - [1995-2004, 52,265 Ohio jobs lost to trade (guardian.co.uk)]

The recession – cyclical or structural?

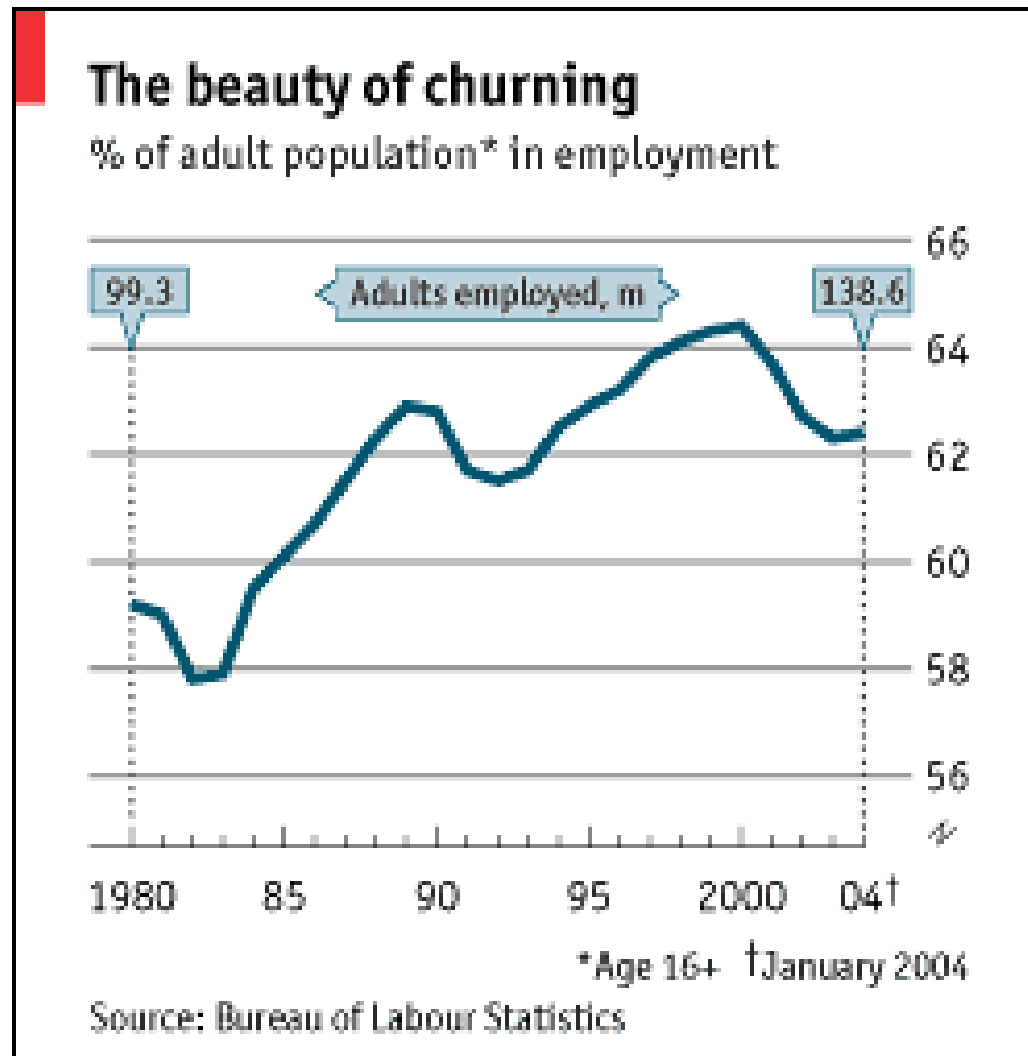
- Overall US economy has lost jobs since 2000
- Likely cyclical – job churning has been going on for years
- Creation of new jobs overwhelms destruction of old jobs (Baumol, Blinder and Wolff, 2003)
- 1980-2002, US population increased 23.9%, number of employed increased by 37.4%

Unemployment rates

Ohio and U.S. Seasonally Adjusted
Unemployment Rates, 1997- September 2004



Job churning



Economic impact of outsourcing

- Trade not expected to reduce output or employment in long-run
- Short-run effects on employment due to job losses
- Workers who lose jobs, suffer loss of income
- Outsourcing expected to raise average real income in US

Policy options and outsourcing

- Proper macroeconomic policies
- Protection likely a costly way to preserve US jobs
- Improve and extend the Trade Adjustment Assistance Program
- Reduce barriers to US service exports
- Education and research to maintain US comparative advantage in services

Are economists wrong on this?

- **Samuleson suggests they might be**
- **Other economists disagree**
- **However, economists have done a poor job in thinking about how those who lose from trade can be compensated by the winners**

Questions?

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