Outsourcing – will your job move to Bangalore?

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AED Economics
Outsourcing – will your job move to Bangalore?

- 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

<table>
<thead>
<tr>
<th>Rate the following challenges facing the US economy, %</th>
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<tbody>
<tr>
<td>A crisis</td>
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<tr>
<td>Budget deficit</td>
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<td>Current-account deficit</td>
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<tr>
<td>Outsourcing jobs overseas</td>
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<td>Baby-boom retirement</td>
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<td>Health-care costs</td>
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### Which candidate has the better policies on the following issues?, %

- **Mr Bush**
- **Mr Kerry**

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<th>Promoting fiscal discipline</th>
<th>Rolling back tax cuts on incomes above $200,000</th>
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<td>Preparing for baby-boomers’ retirement</td>
<td>Health-care policy</td>
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<tr>
<td>Health-care costs</td>
<td>Removing tax deferral on profits of foreign subsidiaries of US firms</td>
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<tr>
<td>Free trade and globalisation</td>
<td>Trade policy</td>
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<td>Creating jobs</td>
<td>Overall, please rate Mr Kerry’s economic plan</td>
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<td>Energy policy</td>
<td></td>
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<td>Economic growth</td>
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*Source: The Economist*

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.

<table>
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<tr>
<th>Cost Category</th>
<th>Mumbai</th>
<th>Kansas City</th>
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<tr>
<td>Cost to Client</td>
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<td>Profit (20% US 100% India)</td>
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<tr>
<td>Labor</td>
<td></td>
<td></td>
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<tr>
<td>Other Costs</td>
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<td>Amortized Equipment Cost</td>
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</tbody>
</table>

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

US Labor Force: Moving From Producing Goods to Services

Source: US Census Bureau, Statistical Abstract 2003
Design: Debbie Campoli/YaleGlobal
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

The beauty of churning

% of adult population* in employment

1980 85 90 95 2000 04†

99.3 Adults employed, m 138.6

56 58 60 62 64 66

*Age 16+ †January 2004

Source: Bureau of Labour Statistics
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