AN ECONOMIC ANALYSIS ON THE EFFECTS OF OUTSOURCING REVISITED

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From politics to consumer lives, outsourcing’s efficiency remains a modern enigma. To define it, “outsourcing, from a business perspective, simply means having a component sourced externally from the firm that sells the final product” to the consumer (Kane, Schaefer, and Fraser). In today’s modern era, “nearly every aspect of a business has the potential to be outsourced, from product design and manufacturing to human resources to marketing and sales;” in addition, “outsourcing has been going on for as long as businesses have existed” (Bovée and Thill, 196-197). The question remains: is outsourcing efficient? Through the following analysis, evidence in terms of layoffs, corporate strategy, and standards of living are analyzed to determine whether outsourcing is truly efficient.

Throughout media, there is an ominous theme of job loss in the American economy; however, as illustrated by Professor Daniel W. Drezner of the University of Chicago, “[b]elieving that offshore outsourcing causes unemployment is the economic equivalent of believing that the sun revolves around the earth: intuitively compelling but clearly wrong” (Drezner, “Outsourcing Bogeyman”). Supporters argue that “while free trade can cause localized pain for a few workers, the overall gains [economically] are overwhelming” for corporations to outsource and benefit the economy (Kane, Schaefer, and Fraser). Ultimately supporters believe a few painful displacements of jobs shouldn’t negate the entire economy’s overall growth; in other words, “some economists continue to assert that short-term gains will lead to long-term gains” because “jobs lost this time around will once again be replaced by other jobs” (Bovée and Thill, 197). Supporters protest that eliminating outsourcing through government regulation won’t save most jobs; “in fact, whenever one industry receives tariff or quota protection [as a result of government intervention], jobs will be lost in other domestic industries” and, as a result, cause more jobs to be lost than saved (Hubbard and O’Brien, 249). Most supporters have found “outsourcing represents less than 1 percent of gross job turnover and brings net gains to the economy;” regulation, not outsourcing, will lead to inefficiency (Kane, Schaefer, and Fraser). To provide empirical data, “fewer than 1 percent of 1.5 million jobs lost in mass layoffs in 2003 were due to overseas relocation, a decline from the previous year” (Drezner, “Jobs”). In fact, “a study by the U.S. Bureau of Labor and Statistics indicates that during the first three months of 2003, outsourcing accounted for only 4,633 of 239,361 jobs lost at a large group of firms” (Hubbard and O’Brien, 234). In addition, supporters argue that the outsourcing-heavy manufacturing industry should blame layoffs on technology and not outsourcing. To illustrate, “the fact that global manufacturing output increased by 30% in that same period [of increased technology] confirms that technology, not trade, is the primary cause for the decrease in factory jobs” (Drezner, “Outsourcing Bogeyman”). Supporters also argue “according to the Bureau of Labor Statistics, the number of outsourced jobs increased from 6.5 million in 1983 to 10 million in 2000... [and] the number of insourced jobs increased even more in the same period, from 2.5 million to 6.5 million” inevitably illustrating job gains and not losses (Drezner, “Outsourcing Bogeyman”). To further support this argument, “insourced jobs are often higher paying than those that are outsourcing” inevitably increasing American wealth (Kane, Schaefer, and Fraser).

In contrast, many opponents want to preserve jobs. Opponents argue that outsourcing devastates livelihoods. To illustrate, “Ohio has lost over 161,000 jobs since 2001 and nearly 53,000 of those jobs were lost as a direct result of foreign trade” (Rescue American Jobs). In the past, low-skill jobs were predominantly the main type of work that was outsourced; however,
when “more valuable activities themselves started to move overseas, quite a few people began to question [economic] theory” and inevitably began many protests against foreign competition stealing decent American jobs (Bovée and Thill, 197). Opponents fear “millions of middle class jobs—from programmers and back-office technicians to Wall Street analysts and architects—will soon find their way from U.S. office parks to the cubicles of Bangalore and Mumbai” (Brown). In addition, Paul Samuelson, Nobel Prize winner in Economics, “argues that the impact of outsourcing [results in]…U.S. workers displaced to jobs that ‘may pay lower wages’ ” than those jobs lost to foreign workers (Hubbard and O’Brien, 12). While Americans are justified in their concern about outsourcing, most evidence suggests hysteria.

To thoroughly understand outsourcing practices beyond layoffs, it is necessary to analyze the economic impact on firms. Outsourcing, from the business perspective, allows firms to offer competitive rates and expand efficiency. To illustrate this best, “proponents say that offshoring is crucial to the survival of many U.S. companies” and such a practice saves jobs (Bovée and Thill, 197). As stated by N. Gregory Mankiw, former chairman of the White House Council of Economic Advisers, “when a good or service is provided more cheaply abroad, it makes more sense to import it than make or provide it domestically” through American jobs (Outsourcing Debate). Inevitably, supporters argue that “[o]utsourcing has many advantages: it gives companies access to new resources and world-class capabilities; it shares the risk of getting the work done; and it frees company resources for other purposes” (253-254). In addition, outsourcing expands innovation as it “allows companies to redirect the capital and resources spent on manufacturing [for example] to new product research and development, marketing, and customer service” (196). In further extension, the supporting ideology believes “traditional economic theory suggests that outsourcing lower-level jobs to countries with lower wages is good for U.S. companies because it frees up money and employees to work on more activities” thus increasing the amount of worker output (Bovée and Thill, 197). Another supporting argument emerges from “Boston University Professor Nitin Joglekar [who]…found that less than 20% of workers affected by outsourcing lose their jobs; the rest are repositioned within the firm” thus implying that increased efficiency (Drezner, “Outsourcing Bogeyman”). Essentially “outsourcing by U.S. companies…generates foreign demand for U.S.-made components” thus causing more prosperity for American businesses (United States Foreign Affairs, Defense, and Trade). Supporters argue that “outsourcing is [simply] about keeping costs down in response to competition” which will allow firms to stay globally competitive (Kane, Schaefer, and Fraser). In addition, “competition among firms [created by outsourcing] ensures that lower costs are passed on to consumers in the form of lower prices. In this sense, outsourcing has an effect similar to a technological change that lowers cost” in production (Hubbard and O’Brien, 235). A specific example of outsourcing functioning as a technological change, “the case of Indian engineers working for less,” demonstrates, from an “economic perspective…the equivalent of discovering a new super computer that can produce more output using fewer resource inputs” (Hussey). Finally, empirical data illustrates that the U.S. gains about 12-14 cents extra for every dollar spent on outsourcing…thus allowing for “U.S. firms [to] save money and become more profitable, benefitting shareholders with increased returns on investments” (Drezner, “Outsourcing Bogeyman”). Ultimately outsourcing reduces costs, gives consumers surpluses, stimulates innovation, and benefits investors.

Despite efficiency, “opponents say that companies are selling out the U.S. middle class in pursuit of profits and starting a trend that can only harm the country” by eliminating countless jobs (Bovée and Thill, 197). To illustrate this opinion nationwide, 64% of Americans thought companies were outsourcing for profits and 30% thought to remain competitive (Pollingreport.com). Opponents argue that American corporations, such as IBM, are “certainly
stepping out with their outsourcing plans” to now move whole operations, in addition to jobs, to other countries (Crane). From a firm’s standpoint, opponents also argue that “outsourcing has its shares of risk, including loss of control, greater dependency on suppliers, and loss of in-house skills” that create successful corporations; furthermore, this detachment has instigated “work delays, unhappy customers, and labor union battles as a [direct] result of outsourcing” (Bovée and Thill, 254). Opponents also question how businesses survive and retain customer satisfaction without directly controlling operations. In the end, opponents believe that eventually implicit costs, for example customer complaints, will cause companies like Dell and Lehman to “partially reverse course once [these] hidden costs of offshore outsourcing become apparent” (Drezner, “Outsourcing Bogeyman”). While efficiencies are created, businesses also risk implicit costs.

By examining the effects of outsourcing on consumers and firms simultaneously, standards of living can then be analyzed. For example, from an economic perspective, “most economists believe that international trade—including the trade that results when firms move production offshore—increases economic efficiency and raises incomes” which in turn raises standards of living (Hubbard and O’Brien, 11). Also, most economists support the theory of comparative advantage which states that the exchange of items or jobs that a country produces most efficiently “will increase a country’s total output and allow both trading partners to enjoy a higher standard of living” (Bovée and Thill, 65). By analyzing the comparative advantage theory, economists thus conclude that “allowing countries to specialize [in labor] accordingly increases productivity across all countries. This specialization translates into cheaper goods and a greater variety of them, for all customers” to enjoy (Drezner, “Outsourcing Bogeyman”). Inevitably, supporters argue “punishing firms that outsource would only erode standards of living by raising the prices Americans have to pay” (Kane, Schaefer, and Fraser). Supporters also utilize analysis of foreign markets to make the claim that “offshoring helps raise the standard of living in other countries and thereby expands opportunities for U.S. companies to export their products” (Bovée and Thill, 197). Finally, some economists argue “study after study has shown that in the long run, [outsourcing restrictions] hurt a country because they remove competition, stifle innovation, and allow domestic producers to charge more for their goods” (67). Inevitably restrictions against outsourcing would lower standards of living because countries aren’t optimally efficient, corporations wouldn’t innovate without extra resources, and global standards of living would diminish due to unequal economic productivity.

Although global growth sounds great to economists, several repercussions affect the local economy. For example, when outsourcing causes layoffs, inevitably the “loss of jobs reduces the tax base, creates high unemployment benefit costs, and raises the cost of government retraining programs” (Terry). Oppositionist protest “when jobs are shipped overseas, the consequences go far beyond the individuals who find themselves unemployed. It affects public schools and services as a result of a smaller tax base, as well as [threatening] small businesses” (Rescue American Jobs). Opponents also argue that firms in reality will refuse to raise standards of living in other countries. In fact, many firms in underdeveloped countries “pay much lower wages than are paid [in high–income countries and] often do not meet the environmental or safety regulations that are imposed in high-income countries” (Hubbard and O’Brien, 251). Although many opponents concede that “globalization has increased the variety of products available to consumers in developing countries,” they argue that a unified global economy will bring “damage to [distinctive] local cultures” (251). The debate stems from theory versus reality.

While no easy answer emerges, the evidence in terms of job loss, corporate strategy, and standards of living sides favorably with maintaining outsourcing levels in an increasingly global
economy. First, government intervention creates a less efficient economy. Second, there is really no need for anti-outsourcing policies as the number of higher paid insourcing jobs continues to exceed jobs lost to foreign nations; moreover, many displaced workers are still employed and repositioned by the firm that outsourced their job. Third, the previous research indicates that outsourcing allows businesses to maximize efficiency, reduce prices, reallocate resources to cultivate innovation, and offer consumers increased standards of living. Although outsourcing proves efficient, opponents are valid in arguing that outsourcing can deteriorate local cultures, exploit cheap, unsafe labor, and create a loss of direct control. While implicit costs of customer dissatisfaction will constrain the degree of outsourcing, limited government intervention will need to protect human rights, environmental conditions, and local cultures. By offering limited intervention to correct these inherent flaws, outsourcing cultivates the very efficiency and innovation that has positively changed the world today.

Works Cited


