



# U.S. Offshoring: Small Steps to Make It Win-Win

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Companies from the United States lead the world in offshoring white-collar jobs to low-wage countries. Today they employ more than 900,000 service workers overseas. But widespread concern about the effects on the U.S. job market has prompted policymakers to call for curbs on offshoring, and some states have already adopted such policies.

Trying to protect jobs this way is a mistake. For one thing, fears of job losses caused by offshoring are greatly exaggerated. New research by the McKinsey Global Institute (MGI) shows

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the United States will likely lose to offshoring no more than 300,000 jobs each year, an insignificant number when set against normal job turnover in the economy: some 4.7 million Americans started jobs with a new employer in the single month of May 2005. Offshoring will also have a negligible impact on US wage levels because of its limited scale.

In addition, curbs on offshoring would deprive the United States of its many benefits and impose new costs instead. Savings from offshoring allow companies to invest in next-generation technologies, creating jobs at home as well as abroad. Global competition also sharpens companies' skills. Conversely, refusing to buy services from overseas will invite retaliation. The U.S. runs a trade surplus in services and attracts more foreign direct investment than any other

country, so it has most to lose from a services trade war.

Policymakers should let offshoring continue. But that doesn't mean they should ignore its consequences. None of the benefits of offshoring currently flow directly to those who suffer most directly, namely US workers whose jobs move overseas. Companies can and should therefore use some of their gains from offshoring to help their displaced employees cope. Wage loss insurance, for example, would cost only a fraction of the savings that offshoring will bring. Governments too, must work with companies to increase retraining, provide life-long learning programs, and ensure portable health and pension benefits. Indeed, all workers need more help in preparing for the faster rate of job change that goes with globalization.

## JOB LOSS WILL BE LIMITED

According to our research, the maximum number of U.S. service jobs that could in theory be performed offshore is 11 percent of total service employment. And, keep in mind that this is a maximum. In reality, we project that less than 2 percent of all U.S. service jobs actually will be done offshore by 2008. We expect that U.S. companies will create some 200,000 to 300,000 offshore jobs per year over the next 30 years.

Why will so few service jobs go overseas?

Only a small fraction of service jobs could ever go offshore mostly because a much larger percentage require face-to-face customer interactions or a worker's physical presence, for example, to stock shelves, provide nursing care, or install networks. In two of the largest service sectors—health care and retail—only 8 percent and 3 percent of jobs respectively could be performed remotely for this reason. And the industries in which the highest percentage of jobs could be performed remotely—packaged software (49 percent) and IT services (44 percent)—represent only 1 or 2 percent of overall employment.

Even fewer jobs actually will migrate for several reasons. About one third of U.S. workers work for companies too small to justify the costs of offshoring. Even larger companies sometimes find the major changes to processes and information systems that offshoring requires to be a significant deterrent. Insurance firms, for example, would need to integrate their legacy computer systems with those of overseas service providers, a massive task. For other companies, a lack of global experience discourages them.

Furthermore, the rational location for many jobs that could in theory be done anywhere will still be the U.S. Companies consider a host of factors beyond labor cost when deciding where to place an activity, including each potential location's risk profile, infrastructure, domestic market, non-labor costs, business and living environment, and the availability of vendors. Against these criteria, the U.S. remains a logical choice for the many companies that do not rank labor cost far above other factors. That is why the U.S. continues to attract so many global jobs from foreign companies.

A new offshore job does not always represent a job lost at home, because many offshore jobs would not be viable at higher wage levels. E-Telecare, a call center vendor in the Philippines, employs one manager to eight customer service agents, compared with a ratio of 1:20 or more in similar U.S. call centers.

Mounting evidence confirms that offshoring is not what lies behind mass layoffs. The U.S. Bureau of Labor Statistics confirms that only 1 percent of service layoffs involving more than 50 employees in the first quarter of 2004 was associated with offshoring.

## IMPERCEPTIBLE IMPACT ON WAGES

Because offshoring has such a limited impact on the U.S. jobs market, its effect on U.S. wages will also be negligible, even in the computer and data-processing industry where offshoring is commonplace. In the U.S., overall employment in that industry has been growing at over 2 percent per year since 2000, compared to 0.4 percent in the rest economy. Although many programming jobs have moved offshore, more positions for systems analysts and software engineers have been created in the U.S. Aver-

age wages have actually grown at a faster pace than elsewhere in the economy, since the new jobs have higher productivity and create more value.

These findings confirm what other research has found. A new study by Mary Amity and Shang-Jin Wei, two economists at The IMF, confirms that U.S. and UK service sectors subject to offshoring are creating as many — or more — new jobs than the ones that move offshore. Another study by Brad Jensen and Lori Kletzer reports that service sectors facing international trade competition, such as software publishing and the securities industry, have fared better in terms of employment and wages than sectors that do not, such as newspapers and waste management.

#### OFFSHORING BENEFITS THE UNITED STATES

Past MGI research found that for every \$1 of cost on services that U.S. companies move offshore, the U.S. economy gains at least \$1.14. The companies doing the offshoring reap 58 cents of these gains. This gives companies scope to invest in new opportunities that create jobs both at home and abroad, to raise

shareholder dividends and to lower prices to consumers.

Offshoring also gives companies access to distinctive skills abroad, making them more competitive. By moving its operations to China, home to some of the world's most sophisticated wireless chip and software designers, one U.S. electronics maker has tripled its manufacturing productivity and, at the same time, cut product development cycle times and defects. In an era of global competition, companies cannot afford to pass up on such opportunities.

The U.S. also benefits as a destination for offshoring companies. In 2004, it received \$121 billion of direct investment from foreign companies, more than any other country. Foreign subsidiaries provided jobs for 5.4 million U.S. workers in 2002. They also accounted for 14 percent of U.S. private sector R&D expenditures in 2002, the last year for which data is available, and 20 percent of U.S. exports.

With the world's most developed and competitive service industries, the U.S. stands to benefit more than any other nation from free trade in

services. In 2003, the U.S. exported \$15 billion more business services than it imported. U.S. trade negotiators are arguing for freer trade in services precisely because so many companies in financial services, accounting, law, consulting, and IT services would gain.

Helping displaced workers is better than protectionism

Continuing to allow offshoring and free trade in services will benefit the United States as a whole. But one undeniable corollary is less job security: there will be more jobs, but a higher level of job turnover. Workers need help coping with the accelerated pace of job change that accompanies openness to trade in services. So rather than trying to prevent offshoring, governments and companies should ease the transition for those workers it displaces, and prepare all workers for more frequent job changes.

#### EASE THE TRANSITION

Not all workers who lose their jobs find new ones quickly, and many that do suffer pay cuts. More than 75 percent of U.S. service workers who lose their jobs due to trade find

new jobs within six months; however, the median wage of those re-employed is 11 percent below its level for their previous jobs.

The U.S. already has two welfare programs targeting workers displaced by trade, the Trade Adjustment Assistance and the Alternative Trade Adjustment Assistance, but neither has been particularly effective. U.S. spending on policies to assist displaced workers, at 0.5 percent of GDP, is low compared with other developed nations—the UK spends 0.9 percent, Germany 3.1 percent, and Denmark 3.7 percent—even though the U.S. has the highest job churn rate.

U.S. policymakers should invest in additional measures to help workers move between jobs, especially job retraining credits for employers, to encourage them to hire displaced workers, and on-the-job training, demonstrably the most effective kind. Continuing education grants will help workers to build skills in demand, particularly from growing areas of the economy such as healthcare, education, and social services. Portable medical insurance plans and pension

benefits are also essential to a workforce changing jobs more frequently.

Companies benefiting from offshoring can ease the plight of displaced workers too. More generous severance packages would help. Companies could also fund wage insurance programs to help fill the gap between workers' previous wages and their new ones, thus encouraging them to avoid long-term unemployment. We have calculated that if U.S. companies spent just 4 to 5 percent of their cost savings from their first two years of offshoring, they could make up 70 percent of lost wages for all full-time employees displaced by offshoring, as well as give them healthcare subsidies for up to two years. Companies may not volunteer to do this on their own, suggesting that some kind of public policy intervention may be warranted.

Indeed, policy makers might consider extending wage insurance to all displaced workers, not just those whose jobs were lost to trade. Globalization and advances in technology require a more flexible and fluid workforce than ever before. But there is no reason that individual workers should bear the full cost of that flexibility. Robert

Litan and his colleagues found that a wage insurance program that insures 30-70 percent of wage loss for two years for all involuntarily displaced full-time workers with two years or more of tenure would cost only \$1.5 billion to \$7 billion (depending on the program design), or \$12 to \$50 per worker per year.

Forward-looking labor unions are beginning to push for similar approaches, rather than trying to protect jobs. For instance, the U.S. IT firm Computer Sciences Corporation (CSC) has agreed with the UK union Amicus that it will retrain 10,000 UK staff when it moves their work offshore. Similar deals have been struck between unions and UK banks. This kind of response to offshoring gives union members a better chance of long-term future employment than struggling to preserve existing jobs.

#### PREPARE PEOPLE FOR MORE JOB CHANGES

Changes to the U.S. educational system are also needed to prepare future workers for more changes of job in their working lives. As well as technical skills, which may become obsolete, students will need business knowledge, and teamwork and communication skills, to be

more broadly employable. Engineering, computer science, and other science programs at U.S. universities should adapt their curriculums accordingly, and combine teaching IT skills with other, less narrowly-focused disciplines, among them business knowledge, psychology, and anthropology. Life-long learning should be an aspiration for all workers in the economy.

At the same time, industry associations, unions and companies can collaborate to help workers anticipate job changes. They could, for example, monitor occupations where employment demand is rising—in healthcare, business services, communications and leisure—and plot potential career paths for workers switching into them. Software programmers may need to become systems analysts; information specialists may need to move into analysis. But companies and unions can identify future employment opportunities and help workers prepare for them.

## CONCLUSION

Fears about job losses and wage cuts in the U.S. due to offshoring are vastly overstated. Protectionism may save a few jobs for a while,

but it will stifle innovation and job creation in the longer term. Rather than trying to stop globalization, the goal must be to let it happen, while easing the transition for workers who lose out.

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