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Toward a Progressive View on Outsourcing

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When Gregory Mankiw, the head of the President's Council of Economic Advisers, remarked on February 9 that outsourcing "is probably a plus for the economy in the long run," he added heat to a debate that has been growing in ferocity as American job losses have mounted and as trade policy has developed into a key issue in the Democratic presidential primaries. In an effort to help develop a progressive position on outsourcing--one that reflects a concern about the well-being of American workers and those in the countries to which many US jobs have fled--we have solicited three views on the subject. We invite readers to respond. --The Editors

Sarah Anderson & John Cavanagh

"Don't worry; they'll get better jobs in the service sector." This used to be the mantra of free-trade supporters when confronted with the shift of auto or apparel jobs to Mexico or China. That line doesn't work anymore, since service jobs, including high-skill computer programming, financial analysis and X-ray reading, are going overseas as well.

Global outsourcing of service jobs is one of the most disturbing manifestations of the US government's corporate-friendly approach to globalization and requires a fundamental reorientation of policy that will aid workers at home and abroad.

Democrats have rightly seized on the issue. They are touting an array of anti-outsourcing proposals, mostly focusing on national measures, such as elimination of taxpayer subsidies. For example, John Kerry advocates banning foreign outsourcing of state and federal government contract work and would also eliminate tax breaks for firms that outsource, while giving tax credits to those that do not. Other US policies that encourage overseas investment could also be targeted. For example:

§ The relatively weak requirements for US firms, compared with European counterparts, to pay severance or negotiate with unions over plans to move jobs overseas.

§ Overseas Private Investment Corporation insurance for corporations investing abroad.

§ Treaties that protect US investors against host-government actions--including public interest laws--that diminish profits.

Changes in these and other areas could help chip away at the incentive to outsource. However, such domestic remedies do not address the main driving force: the extreme gap in wage levels. For example, the average wage gap between the United States and India, the top outsourcing destination in the developing world, is more than 12:1 for telephone operators and about 9:1 for medical transcribers, according to a University of California, Berkeley, study. The next biggest developing-country draw for service work is China (which has rock-bottom wages but lacks India's English-speaking advantage), followed by Mexico, where the wage ratio with the United States is about 8:1.

Overall, global pay gaps result in cost savings for outsourcers of at least 45-55 percent (after accounting for higher infrastructure and other costs), according to the management consulting firm McKinsey and Company. If this is true, figures in the Berkeley study suggest, companies could save around $300 billion a year if they outsourced all of the estimated 14 million US service jobs considered vulnerable to being shipped overseas. Given these vast potential savings, it will be difficult to reduce outsourcing incentives substantially--unless the pay gaps are narrowed.

Of course, this is no easy task. Economists often claim that productivity growth is the key to boosting wages, but this has not been the experience of many developing-country workers. The key impediments to rising pay appear to be rampant unemployment, labor repression and increased employer power to play workers off against one another in a globalized economy. While national governments are not without responsibility for these problems, international financial institutions and trade agreements have also played a role.

For example, the Chinese government estimates that reforms required by the World Trade Organization will destroy the livelihoods of 20 million farmers. Mexico has lost 1.3 million agricultural jobs under the North American Free Trade Agreement, according to the Carnegie Endowment for International Peace. Urban workers have also been squeezed, as governments, cheered on by the World Bank, have shed workers through privatization. Nearly 26 million Chinese public-sector employees lost their jobs between 1998 and 2002. Rather than foster domestic demand for locally produced food, goods and services, these policies insure an almost bottomless pool of cheap labor.

In this context, it is understandable that workers in these countries line up in droves to apply for positions with US firms. But this doesn't mean these jobs will deliver a better tomorrow. The export jobs on the Mexican border and in southeast China are often dangerous and pay below a living wage. Chinese workers' efforts to win improvements are stymied by an official ban on basic union rights, while in Mexico repression of independent unions in the export factories is unofficial but nearly as effective.

In India, jobs in the international service industry, especially those that are more highly skilled, tend to pay well by national standards. However, labor unions have not gained a foothold in these firms either, and there is a nagging fear that these jobs will evaporate as soon as better deals can be found in the Philippines or elsewhere. Mexico offers a haunting lesson, as the country has hemorrhaged several hundred thousand export jobs in

the past few years, many of them to China.

In addition to promoting changes in global trade and finance policies, the US government could learn from the European Union's experience in using targeted aid and common labor and social standards to lift up poorer countries in that region. Living standards in Portugal and other poorer European countries have risen so much that the EU has been able to lift barriers to free-labor movement among member states. They have committed to doing the same for new Eastern European entrants.

The goal should not be to completely eliminate the far greater gaps between the United States and countries, like China and India, that are magnets for American jobs. The point is that the US government should begin to adopt a long-range view and recognize that it is in our self-interest to respond to the outsourcing scare with an approach that goes beyond domestic measures to tackle the global policies that are widening the economic divide. It should offer mechanisms for transferring resources to poorer countries, through debt reduction where appropriate, or aid that benefits the poorest instead of the Halliburtons. And the United States should be a leader in collaborating with other rich nations to expand debt reduction and effective aid programs. Finally, the new approach should include supports for internationally recognized labor rights as well as punishments for corporations that violate them.

Narrowing the global pay gap cannot be accomplished in the course of one or even two presidential terms. But if we do not begin the struggle, the pivotal battle for long-term economic health will certainly be lost.

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Jeff Madrick

Gregory Mankiw's comment that the outsourcing of jobs is good for the US economy properly reflects a few key tenets of broadly accepted trade theory. When a company contracts services or manufacturing to a lower-wage nation, it reduces costs and cuts the prices of its goods and services. This surplus amply benefits consumers, and in general allows the United States to make at home what it makes best.

In fact, it's hard to have taken even a couple of economics courses without essentially agreeing with Mankiw's point. I partly place myself in this camp. But the comments of the Bush Administration's chief economist were still infuriating. They oversimplified trade theory, for one thing. But more disturbing, they were issued by a member of an Administration that is presiding over a jobless recovery and showing only insensitivity to the considerable pain of massive job dislocation and slow wage growth that the theory itself predicts. Most important, the remarks, and most of the reaction to them, overlook the possibility that something new is occurring in the age of both the Internet and the rapidly growing low-wage economies in Asia and the Far East.

For evidence, take the current recovery. Job growth may yet arrive, but by historical standards, a million or two new jobs at least should already have been created. Manufacturing jobs in particular, the easiest to export, are being lost by the millions and are now down to a level first reached in 1958. Weak labor markets are showing up in poor wage growth. Josh Bivens of the Economic Policy Institute points out that labor compensation has gained less in the current economic recovery than in any other in the post-World War II period. The growth of Gross Domestic Product is flowing largely into profits.

No one really knows how many jobs are being outsourced these days, and odds are that the numbers are less alarming than those bandied about. But one survey found that more than 40 percent of US businesses say the weak job market is due to outsourcing of domestic jobs. And job outsourcing is now moving up the skills ladder, meaning America's high level of education may no longer protect workers. Even if we are not already outsourcing as many jobs as is feared, the nation may be on the verge of a far faster growth in the trend.

One of the infuriating ironies of Mankiw's comments is that the beneficent theory he alluded to, and that so much of the media defended him for, applies fully only when unemployment is low, a fact not mentioned by him or anyone I read. "Conditions of full employment are required to validate standard propositions in trade theory," said former Federal Reserve vice chairman and Princeton economist Alan Blinder years ago in a speech to the American Economics Association. "High unemployment calls many of these propositions into question." Without full employment, which is determined by other factors, such as fiscal and monetary policies and the normal machinations of the economy, it is theoretically possible that gains from trade will not outweigh the losses due to job dislocation and lower wages.

This Administration has surely not produced a full employment economy. To the contrary, it has cobbled together one of the most inefficient sets of economic policies imaginable--tax cuts mostly for the rich over ten years and rapid increases in military spending. At the same time, the Bush Administration refuses to address seriously the inevitable pain for large swaths of dislocated workers, and the likely dampening effect on wages as well, that free-trade theory routinely predicts. According to many studies, in fact, workers who have lost jobs in general during the past couple of decades have had to take a pay cut on average to get a new one. A newer study shows that workers who lose jobs specifically because of trade take a still bigger pay cut on average.

But should the Democrats be calling for legislation that raises tariffs or restricts outsourcing? Sparingly at best, I would argue. The reason is that even with the above concerns, there is so large a difference in wages and costs of production between rich and poor nations that the benefits of free trade and outsourcing--the so-called surplus--are potentially enormous. Even with some unemployment, these benefits will probably be considerably larger than even the properly measured costs of job dislocation. (Early pro-free trade studies seriously underestimated these costs, by the way.) In addition, if business cannot avail itself of overseas labor and lower-priced imports, it may simply lose world market share to other nations' businesses. Many companies will just close their doors. Finally, most forms of protectionism, such as tariffs, are crude and cannot be easily

targeted at the firms and industries that warrant protection.

Still, where does that leave the workers who are hurt? What Democrats should be arguing is that if freer trade and outsourcing are inevitable, there is a clear and urgent policy choice for government. First, the best protection for jobs is full employment. In the high-employment late 1990s, for example, the wages of all income groups rose. Even the best policies might not have provided full employment in current conditions, but the Bush Administration's tax cuts for the rich over time delayed the expansion and created long-term nervousness about the federal budget deficit, which may already have affected hiring decisions. Far more effective would have been a sharp, front-loaded and temporary tax cut aimed at middle- and low-income workers, who would have spent it quickly. Better would have been direct government spending on education, healthcare and infrastructure and on bailing out strapped state governments.

Second, the government should provide ample protection for those who must pay the largest price for free trade. Workers lose jobs, cannot find equivalent ones and often lose their pension and healthcare benefits in the process, or see them reduced. They are typically inadequately educated for the new jobs available. But this Administration has resisted expanding unemployment benefits, it has not adequately funded its much-ballyhooed education program and it has made no serious effort to expand public healthcare coverage. In their hearts, I believe, Administration officials would like nothing more than to privatize Social Security and Medicare in a second Bush term, which would be particularly hard on low-wage American workers--the very workers mostly losing jobs because of trade. The Administration has certainly come up with no interesting new ideas to protect workers except ubiquitous tax cuts.

The Bush Administration apparently largely operates by the nineteenth-century principle that if you don't have a job it is your fault. But it stands by a set of trade principles--at least when it suits it--that will force job losses through no worker's fault. Such hypocrisy deserves the attention of the political opposition.

Innovative ideas that target aid for displaced workers are welcome, and are the best political weapons. Wage insurance might be one. It would pay displaced workers who found a new job a wage supplement to compensate for their lower pay over a year or two, enabling them ideally to learn new skills on a job.

There are other potential problems from outsourcing in addition to direct job losses and faltering wages. For one thing, lost jobs mean less demand for goods and services at home. Yet historically, thriving domestic demand has been a critical US advantage. In thinking about the theory of free trade, it's also hard to escape the fact that most rich nations today have a long history of high tariffs and quotas. Greater protectionism in the rich nations in my view would be damaging. But it is not necessarily the open-and-shut case many often arrogantly make it out to be.

Meantime, Bush Administration officials are oblivious to the implications of even their own traditional theoretical beliefs, and they should be required to explain themselves.

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Doug Henwood

Whatever happened to the once-touted Great American Jobs Machine? Lately it seems to have popped a gasket. More than 700,000 jobs disappeared between the official end of the recession in November 2001 and January 2004 (the latest month available), unprecedented behavior during a supposed economic recovery. Where'd they go?

Abroad, is the standard answer, to factories in China and call centers in Bangalore. "Outsourcing" and "offshoring" are the polite ways of putting it, the words preferred by consultants and pundits. In the cruder version, it's "foreigners are stealing our jobs." In the mainstream, the major difference of opinion is whether this is a good thing or not in the long term. The President's top economic adviser, Gregory Mankiw, got into some seriously hot water the other week for saying that the phenomenon represented only the "latest manifestation of the gains from trade that economists have talked about" since the days of Ricardo, two centuries ago. To Ralph Nader and the Democratic presidential candidates, it's a bad thing that explains much of the job market's ills, one of the issues they hope to ride into the White House. Most progressives accept the analysis. The problem is that it doesn't seem to be true.

Let's look at some hard numbers. Since the peak in employment in March 2001, the US economy has lost 2.4 million jobs. But that actually understates the jobs deficit. Historical averages for normal postrecession job growth indicate that employment should be some 8 million higher than it was in January. But estimates of outsourcing, while imprecise, are in the low- to mid-six figures, suggesting that it can explain no more than a twentieth of our jobs problem. And in a more "normal" economy, the US economy would generate half a million jobs every two months. Something else is clearly awry.

The most widely cited projections for offshoring come from Forrester Research, which estimated in a November 2002 report that 3.3 million service-industry jobs would go offshore by 2015. That looks like a big number, but it needs to be put in perspective. In January the United States had 108 million service jobs. According to the Bureau of Labor Statistics, the economy should add 22 million jobs between 2000 and 2010 (almost all of them in services); if we stretch that projection to account for the additional years in the Forrester study, that's 33 million. So the best estimates we have are that the outsourcing total equals about one in thirty of today's jobs, or one in ten of the next decade's new jobs.

Of course, these are headline-level statistics, aggregating sectors and occupations. Most of the job losses in the United States in recent years have not been in services, the main focus of offshoring worries, but in manufacturing. That sector has lost 3.3 million jobs over the past six years, or one in five--far more than during the early 1980s recession, the period that gave us the term Rust Belt.

Everyone knows where those went--Mexico first, then China, right? Maybe not. A study of twenty major economies done last fall by Joseph Carson, the chief economist at Alliance Capital, found that factory employment declined by 11 percent between 1995 and 2002. Brazil lost 20 percent of its manufacturing jobs, and China, rather stunningly, lost 15 percent (mainly because gains in the new private-sector enterprises weren't enough to offset losses in failing state enterprises). Factory employment rose in a handful of

countries, but mostly by small amounts. The major reason for the shrinkage, Carson and other economists have explained, is the same as it's been for decades: Machines are doing more of the work, and people, less.

There once was a time when the service sector was expanding enough to offset losses in goods production. That hasn't been happening lately. Since the end of the recession, private service employment has expanded by just 619,000.

So what's up? We can never know for sure, but it's likely that this is what a postbubble economy looks like. After its bubble burst in 1989, Japan lived through more than a decade of economic stagnation, and it was years before people realized that the problem wasn't a matter of a short-term business cycle but something more profound. It's exaggerating only slightly to say that may be what a depression looks like in these days of big governments and indulgent central banks: no outright collapse, but no strong recovery either. But despite sustained low interest rates and bursts of public works spending, the Japanese economy just flatlined its way through the 1990s, and is only now showing signs of serious recovery.

Something similar may be happening here. Driven by exuberance and easy money, the bubble inspired firms to expand and hire aggressively; when the bust came, they were badly bruised. As a result, managers remain very wary about taking on new permanent staff. Worsening the problem is heavy pressure from Wall Street to get profits up; the easiest way to do that is to squeeze the existing work force harder. Almost every employed person you talk to has a tale of surviving workers' taking on the responsibilities of employees who leave voluntarily or are laid off. Pundits cite this as evidence of a continuing productivity miracle, but the reality of it is less glamorous--working harder and longer for no increase in pay. But it's much easier to look abroad for the source of our woes than it is to investigate the home-grown reasons.

Whatever the causes, though, our treatment of the unemployed and displaced is scandalously cruel. Fewer than half of the unemployed are drawing benefits. Public expenditure on retraining and job creation is risibly small. There's plenty that could and should be done here, from classic public works projects to less traditional ones like subsidized childcare. These should be the real issues; next to them, "offshoring" is a diversion.

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