

# Virginia Viewpoint

## The Truth about Outsourcing

By Atin Basuchoudhary, Ph.D.

### Summary

For businessmen, outsourcing is a tool used by one's competitors in the global marketplace. For economists, outsourcing is a tool for creating wealth and generating a higher standard of living. For politicians looking for an issue to demagogue, outsourcing is a godsend.

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***Protecting American jobs at a non-competitive wage rate only directs resources and jobs away from the competitive sectors leading to a stagnating economy where everyone is poorer.***

Outsourcing has become the topic “du jour” in Washington D.C. and Martinsville, VA. Reports from the media suggest that U.S. corporations are jettisoning domestic employees and hiring foreign employees to reduce costs and increase profits. It would seem that mammon has won again at the expense of the little guy. To combat this, Congress has restricted the award of federal contracts to firms that outsource work to foreign countries – a bipartisan effort! State legislators in Kansas and Missouri are rushing to emulate their colleagues in Congress. What’s going on?

In the past the debate over job losses due to trade focused on manufacturing jobs. This issue still comes up even though scientific evidence (as opposed to anecdotal evidence) suggests that most manufacturing job losses have come about as a result of changes in technology. Jobs have moved overseas because U.S. workers in those jobs are less productive than their foreign counterparts relative to the wages they desire. In other words, if corporations were not allowed to send those jobs overseas they would simply use relatively cheap capital rather than hire expensive American workers. At any rate many Americans in the '80s and '90s had gotten used to the reality that there were fewer manufacturing jobs available – that they needed to upgrade their skill sets and enter the high tech arena to be guaranteed jobs in the future.

However, the current debate over outsourcing focuses on so-called “hi-tech” jobs. Apparently, hordes of U.S. techies have lost their jobs to their foreign counterparts. Should their jobs be protected?

We must realize that what is high tech today is not high tech tomorrow. People trained as high tech workers in the '80s will find little use for their skills in the 21<sup>st</sup> century for two reasons. First, the technology on which they were trained has been overtaken by more sophisticated technologies. Second, their technological skills have become standardized, effectively becoming low skilled, and therefore easily replicable. Enter India with its armies of educated, English-speaking workers who can produce the same results for less. If this were the endgame then indeed we would have cause to be worried. But it is not. Innovation has proceeded apace in America. Other fields have developed that supply today's high tech jobs. This is the “creative destruction” process of capitalism. The trick for the American worker is to know how this process works and then to take advantage of the endless opportunities inherent in the process. Protecting

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current jobs will only stultify the innovation process by taking away the incentive to innovate. Why would anyone want to innovate if they do not have the ability to move resources from old technologies to newer more profitable technologies? Protectionism leads to economic stagnation.

Proponents of protectionism seem to think of the economy as a zero sum game. If “they” are gaining jobs, then “we” must be losing them. That is not how trade works.

U.S. corporations become more profitable by outsourcing (otherwise they would not be doing it!). As the U.S. economy expands, it provides more opportunities for Americans. Indeed, we are seeing the U.S. economy expand in an unprecedented way. However, the job numbers are unclear. As of 2004, employer surveys showed 2.4 million job losses. But household polls indicated a gain of 208, 000 jobs. This makes sense in a scenario where large firms increasingly outsource jobs to smaller *American* businesses.

On the other hand, “they” gain as well by getting access to better paying jobs. These job gains increase the wealth of foreign countries allowing them to consume more goods and services – both domestic and American. Thus, over time everyone has access to better paying jobs in larger economies.

However, it is not possible to deny short-term dislocations. But let’s get the issues straight. Outsourcing results in fewer jobs of *a particular type* in the U.S. because Americans are unwilling to do the work at a wage that foreigners are willing to accept. But protecting American jobs at a non-competitive wage rate only directs resources and jobs away from the competitive sectors leading to a stagnating economy where *everyone* is poorer. If the state machinery is to be invoked at all, it must be to protect Americans – not job descriptions! Protecting some jobs at the expense of Americans and their future is just wrong.

Congress and state legislatures are intervening against outsourcing by not awarding government contracts to firms that outsource. In other words, they are voting in favor of more expensive government – a cost that ultimately must be paid by the taxpayer. Moreover, particularly for states, expenditures on things such as roads, security, and education must be reduced to pay for more expensive contracts with firms that do not outsource.

We need to remember that trade enhances our prosperity as Americans. A politician’s desire to gain a few votes by sowing fear and discord is a dangerous game. It may boomerang in the short run if other nations decide to stop outsourcing their jobs to our shores! In the long run it will reduce economic growth and it will make all of us poorer. Protecting job descriptions makes us, and our children, less prosperous.

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