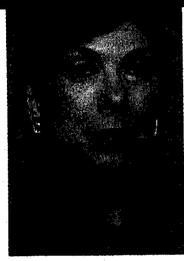
Economic Viewpoint



BY LAURA D'ANDREA TYSON

Outsourcing: Who's Safe Anymore?

The American economic recovery is more than two years old. But jobs and worker incomes have yet to rebound. If this recovery had followed the typical pattern of past recoveries, by now the economy would have created more than 8 million additional private-sector payroll jobs. According to Stephen S. Roach of Morgan Stanley, employment is even 2.4 million jobs lower than the level predicted by the economy's performance during the 1991-92 economic upturn, until now America's worst jobless recovery. And slack labor demand has depressed wage and salary growth. Since the beginning of the recovery two years ago, payouts are down 1% in real terms—in a typical rebound, they would be up by nearly 8%. The difference translates into about $350 billion of missing income for America's workforce. What's going on?

NO ONE KNOWS FOR SURE, but a growing number of observers point to American companies' outsourcing and offshoring strategies as the force altering the usual links between economic recovery and employment growth. Rough estimates suggest that the U.S. has lost 400,000 to 500,000 information-technology-processing jobs to outsourcing over the last few years. It's a small number in an economy that employs around 130 million workers, but outsourcing is moving quickly up the wage-skill chain from call-center employees to software engineers, medical specialists, lawyers, and financial analysts. Observers may disagree about outsourcing's role in the current cyclical recovery, but outsourcing will clearly be a powerful source of structural change in labor market dynamics over the next decade. Forrester Research Inc. estimates that about 3.3 million American jobs in business services alone will be shifted overseas during this period. The actual number of American jobs, including high-wage, high-skill jobs, in jeopardy is likely to be considerably higher.

According to standard economic theory, the outsourcing of services, like the outsourcing of manufactured goods, is good for the American economy. It'll enhance the productivity and competitiveness of U.S. companies and increase the demand for their other goods and services and for the U.S. workers who produce them. In addition, as foreign incomes grow, the demand for U.S. exports will expand, providing new domestic high-wage job opportunities. In a recent study, Catherine L. Mann of the Institute for International Economics analyzed the outsourcing of manufactured components by U.S. computer and telecommunications companies in the 1990s. She concludes that outsourcing reduced the prices of computers and communications equipment by 10% to 30%. This stimulated the IT investment boom and fueled the rapid expansion of IT jobs. She argues that the offshoring of IT services will have a similar effect, creating jobs for U.S. workers to design, tailor, and implement IT packages for a range of industries and companies.

Mann acknowledges that outsourcing is often painful for displaced workers. She urges that trade-adjustment assistance and wage-insurance programs currently offered by Washington to manufacturing workers who lose jobs to foreign competition be extended to white-collar workers displaced by outsourcing overseas. As outsourcing grows, so too will the importance of public policies in education and training, in health-care insurance and pension portability, and in unemployment-compensation programs that foster the skills and mobility of the U.S. workforce. Unfortunately, growing federal budget deficits will limit help to workers displaced by outsourcing.

The federal budget deficit will limit help to displaced workers

So far the debate about the benefits and costs of outsourcing has focused on jobs, not wages. Yet the risks to the latter may be more important. Over the past 30 years, the wages of low-skilled American workers, those with a high school education or less, declined both in real terms and relative to the wages of skilled workers, especially those with a college education or higher. Technological change and outsourcing decreased the demand for low-skilled U.S. workers.

Now the outsourcing of high-skill jobs threatens to shift demand away from high-skilled workers to cheaper substitutes in Asia. Like the assembly line revolution that cut demand for skilled artisan workers during England's industrial revolution, the new wave of outsourcing may prove to be a technical change that curtails demand for many U.S. skilled workers. The outsourcing of high-skill American jobs may yield economic benefits for the nation. But there may be a sizeable number of losers as well. ■

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