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Misplaced Fears

Why the outsourcing scare is overblown.

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Although the media for the time being has shed its panic over the outsourcing of jobs abroad, the issue nonetheless remains dangerous, not to American jobs directly, that was always overblown, but because the fear of outsourcing presents a powerful and ongoing political temptation to protectionism. Certainly campaign rhetoric in this election season testifies to that fact. The stakes are high. Even a hint that the United States might withdraw support for the world's free-trade regime (painstakingly developed during past decades) threatens global growth prospects and consequently more American jobs than any Chinese toy factory or Indian call center could. It is critically important, then, to put this situation into perspective.

The issue of outsourcing overseas is neither new nor is it as overwhelming as some suggest. At base, it is just the latest installment in the long-standing challenge to the United States from cheap foreign labor, one that began in the 1950s, when European wages were low, and has continued over time with a shifting focus to various countries. Since it is not new, it does not require new solutions, especially a dangerous protectionist response. The United States has managed throughout this long time without resorting to protectionism. It has instead met the challenge of cheap foreign labor successfully with impressive gains in labor productivity and ongoing innovation. The country can do the same in the present instance, too.

There can be little doubt that today's challenge from low foreign wages is as great as it has ever been. A few simple comparisons illustrate. According to IBM, a Chinese programmer with three to five years of experience earns the equivalent of around $12.50 an hour. His American equivalent makes closer to $56.00 an hour.

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American firms operating in Bangalore, India, note that a software engineer there makes about $30,000 year, less than one-sixth of his Silicon Valley equivalent. The average English-speaking telephone operator in India makes about $1.50 an hour, compared with $11.00 for a similar operator in the States.

Such vast wage differences seem insurmountable and lead naturally to frightening views of a future full of unemployment and poverty. Feeding that fear is a report from the Gartner Group, an independent consulting firm. It indicates that some 80 percent of American boards of directors have responded to such wage differentials by discussing outsourcing offshore. More than 40 percent have completed some sort of a pilot project. Forrester Research, another private consulting group, estimates that this country will export a total of 3.3 million white-collar jobs by 2015, including 1.7 million back office jobs and 473,000 positions in information technology. The Department of Commerce has extrapolated recent trends in outsourcing and estimated that service imports of legal work, computer programming, telecommunications, banking, engineering, and management consulting will rise rapidly from last year's level of about $17.4 billion to erase the country's trade surplus in services in just a few years.

But such frightening projections are nothing new. For more than half a century, wage differentials between the United States and some foreign rival have always seemed insurmountable, at least at first, and people have feared the worst. In the 1950s and 1960s, financial journalists and politicians fretted that the country would lose all its manufacturing to low-wage German labor. It is hard today to think of German labor as cheap, but it was back then. After the European scare, there was Japan, with automobiles in the 1970s and more generally in the 1980s. It, too, occasioned dire predictions. Then it was Mexico and now China and India. At each phase, of course, ongoing changes in technology and the economies of the world rendered different jobs vulnerable. The particular institutional arrangements altered, too. With Europe and Japan, the competition came mostly from foreign firms, whereas more recently, it has come from American firms subcontracting to their own foreign subsidiaries. But at base, the story has consistently been one of low-cost foreign labor.

At each phase during this long period, the forecasts of disaster sound remarkably like today's doomsaying. John Kennedy, for example, in his 1960 presidential campaign, spoke of foreign competition carrying "the dark menace of industrial dislocation, increasing unemployment, and deepening poverty." Twenty years later, when the threat came from Japan, prominent financier Felix Rohatyn talked about, "de-industrialization" and the prospect of America becoming, "a nation of short-order cooks and saleswomen." At that same time, then-Senator Lloyd Bentsen (D-TX) worried: "American workers will end up like the people in the biblical village who were condemned to be hewers of wood and drawers of water." A short while later, Walter Mondale, while serving as U.S. ambassador to Japan, suggested that Americans would soon be fit only to sweep the floors in Japanese factories. By the late 1980s, when Japan was beginning to fall into stagnation and the foreign threat had shifted to Mexico, then presidential candidate Ross Perot could hear the "giant sucking sound" of lost jobs. On the verge of the great technological leap of the 1990s, a Pulitzer Prize went to two journalists, Donald L. Barlett and James B. Steele, for their book on America's decline, *America: What Went Wrong.*

Almost all these ugly outlooks have come equipped with calls for protectionist measures. Fortunately, the nation has resisted this misguided political solution. The United States instead has coped by applying its genius for productivity enhancement. Ever-higher levels of productivity allowed

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WHITE HOUSE

American workers to warrant their relatively high wages, even if it meant fewer workers on a given project. And the country has coped through technological innovation and product development to create new jobs for otherwise displaced workers in new and previously unimagined industries and pursuits.

The stress on productivity probably would have occurred even without foreign competition. American producers would still have responded to this country's high wages with robotics and other labor-saving techniques. Their efforts would still have raised the productivity of some workers and forced layoffs on others. Receptionists, after all, have faced a similar experience from the introduction of voice mail, even though foreign competition has hardly applied to them. The same could be said for bank tellers and ATM machines. Middle management has faced the same from improved systems and communications, even in those areas where foreign competition is not an issue. Some of the jobs lost to automation and systems have, of course, reappeared overseas, not because they were stolen, but rather because the low wages abroad relieve those operations of any need for labor saving techniques. Either way, high-paid American labor has lost the jobs.

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Those displaced by heightened productivity, whether inspired by foreign competition or not, have suffered until ultimately innovation created new industries with new employment opportunities. Throughout the transition, of course, people have doubted that the new industries and new jobs would develop. That is understandable, since at any point in time it is difficult to envision where innovation will take the economy. In the 1950s and 1960s, for instance, when cheap European labor threatened America's traditional steel industry, few could imagine how the telecommunications and technological revolutions of the last forty years would employ millions in previously undreamed of jobs. In the 1970s and 1980s, when Japanese competition threatened employment in the auto industry and some of the new areas of technology, people could not see how innovation in this country would create a separate revolution in finance that transformed an industry dominated by bank clerks into one that employs millions at all levels, many in high-paying advisory positions that did not exist even twenty years ago. Similarly, cable and direct television have made their own employment revolution, creating jobs for millions at all skill and pay levels from technicians to executives. These are only the most obvious illustrations of the opportunities that have absorbed many of those displaced from more traditional industries for whatever reason.

With this innovation and productivity growth, the United States has put the lie to those ongoing forecasts of unemployment and poverty. Instead, the country has become more prosperous. In the past twenty years, for example, the growth of the information economy has created an 80 percent increase in management positions from 23.6 million in the early 1980s to 42.5 million today. The proportion of such challenging, high-paying jobs has risen from 23.4 percent of the workforce to 31.1 percent. Testifying even more broadly to the effectiveness of productivity growth and innovation, the nation's standard of living has risen throughout this time, and impressively so. According to the Commerce Department's Bureau of Economic Analysis, per capita income last year averaged $28,215, up 175 percent in real terms from 1960, 58 percent from 1980, and almost 20 percent even from the boom year 1996. Clearly, most workers, if not every one, are doing better than they once were, despite the foreign competition.

For all the opportunity, there is no denying that the transitions forced by these patterns have also imposed great hardship on groups of workers and regions of the country. These deserve attention. But it is misguided to extrapolate such hardship to make endless warnings of general economic collapse and call for protectionist measures, especially in the face of the remarkably successful historic record. Looking forward, there is, of course, always the risk that the solutions of the past will fail, that the productivity growth will falter or the innovation fade. But the prospects of such a radical departure from past trends is not especially likely. Even though few today have the clairvoyance to paint a definite picture of future innovations and the new job opportunities, the long record of the past certainly raises the odds that they will occur and that the country will cope without the need to resort to protectionism. ◆