Free Trade Bulletin

Why We Have Nothing to Fear from Foreign Outsourcing

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Foreign outsourcing, or offshoring, is being blamed for job losses in the information technology (IT) sector. Announcements of jobs being moved to India and other low-wage countries have provoked criticism of "Benedict Arnold" CEOs and calls for governmental restrictions on the practice of outsourcing. But critics who scapegoat outsourcing are ignoring the realities of today's IT labor market.

Contrary to the popular perception, foreign outsourcing is not to blame for the deep recession that struck the information technology industry beginning in early 2000. The IT recession began in March of that year when the dot.com and telecom bubbles burst, and the tech-laden NASDAQ lost three-quarters of its value during the next three years. Meanwhile, business investment collapsed during the 2001 recession, reducing domestic demand for both IT hardware and services. The terrorist attacks of September 11, 2001, and the ensuing war on terrorism put a further chill on business confidence. Adding to the IT sector's woes were corporate scandals and slow growth abroad among our major trading partners. Foreign outsourcing was not an important variable in the equation.

A fundamental mistake made by the critics of outsourcing has been to confuse the passing pain of the IT recession with an alleged long-term decline in the sector. That mistake is compounded when current output and employment levels are compared with levels at the frenzied peak of the boom in 2000 rather than with more normal levels from the late 1990s. A more accurate and less alarming picture of the industry emerges if we compare the state of the industry a few years after the bubble burst with its state a few years before.

Beginning in the early 1990s, with the takeoff of Windows-based computing and the Internet, employment in the IT industry surged. Employment in software and related services grew by one million between 1993 and 2000, before dropping by 166,000 between 2000 and 2002.[1] The story has been much the same across other IT sectors: stupendous growth throughout the 1990s, then a pullback in employment

of 10 to 20 percent during the recession. In the IT industry as a whole, employment levels even after the recession were still no lower than in 1998. During the past decade, annual employment in the industry has still grown at a rate twice as fast as employment in private industry in general.[2]

Despite the turbulence of the past four years, the U.S. information technology services sector remains a major force in the U.S. economy. The software and computer services industry accounted for $278 billion of U.S. GDP in 1999, before the hurricane hit, and an estimated $329 billion in 2003, long after its fury had been spent. Communications services accounted for $232 billion of GDP in 1999 and an estimated $292 billion in 2003. Even as a share of total U.S. GDP, the IT services industries accounted for 5.6 percent in 2003, slightly higher than their share before the storm.[3] The IT services that are moving offshore are being more than offset by increased output here at home. Any sluggishness in employment growth has been because of rising productivity, not because of falling production.

The jobs that have been lost in the IT sector tend to be the lower skilled and lower paid jobs in the industry—just as trade theory would predict. From 1999 through 2002, total employment in the IT industry did drop by more than a quarter of a million, from 6.24 million to 5.95 million.[4] But declining employment was concentrated in those occupations requiring relatively low or moderate levels of training and education.

The biggest drop in employment was among data entry keyers and electrical and electronic equipment assemblers, jobs that may require vocational training but not typically a bachelor's degree. Job losses were also heavy among IT occupations requiring even less education and training, such as billing and posting clerks, machine operators, communications equipment operators, and computer and office machine operators. From 1999 through 2002, total jobs in the first category requiring moderate education and training declined 14.6 percent, and those in the second category requiring the least education and training declined by 10.5 percent.[5]

In contrast, the number of jobs in the IT industry that require a relatively high level of training and education was actually slightly higher in 2002 than it was in 1999. In the year before the dot.com and telecom bubbles burst, the industry employed 3.43 million workers whose jobs required an associate's degree, bachelor's degree, or work experience plus a bachelor's degree or more. After a surge of hiring in 2000, followed by a painful shakeout, the number of such highly skilled workers stood at 3.51 million in 2002, up 2.3 percent from 1999.[6]

Contrary to the popular angst that "our best jobs" are going overseas, the best jobs appear to be staying here. In fact, as a share of the IT workforce, those jobs requiring relatively high skills increased from 55 percent of all jobs in 1999 to 59 percent in 2002. Just as the free traders predict, we are swapping less skilled and lower paying jobs for relatively higher skilled and better paying jobs.[7]

The recovery and expansion of job creation that has already begun in the IT sector should continue into the future. According to the U.S. Department of Labor's biannual projections, the number of jobs in computer and mathematical science occupations is expected to increase from three million to four million in the next decade, a rate of growth twice as fast as employment in the rest of the private economy.[8]

"The demand for computer-related occupations should increase, despite the recent downturn, as a result of rapid advances in computer technology and the demand for new computer applications, including those for the Internet and Intranets," the department reported in the February 2004 issue of its *Monthly Labor Review*. "Growth will not be as rapid as during the previous decade, however, as the software industry begins to mature and as routine work is increasingly outsourced overseas." Most of the new jobs will be in computer systems design and related services and in the information industry, primarily in software publishing, data processing and related sectors, and Internet-related industries.[9]

Of course, the IT recession has been painful for hundreds of thousands of workers who lost jobs and were forced to find new employment. Compensation in the industry has also been under pressure because of the temporary drop in demand for services and workers. Average wages fell 1.3 percent in IT-producing industries in 2002 from the year before, from $68,330 to $67,440 (in contrast to a 1 percent increase for other workers.)[10] But IT jobs still remain among the best paying in our economy, and we have solid reason to believe opportunities for employment in the field will expand in the coming decade.

The United States continues to enjoy tremendous advantages in global IT competition. Our domestic economy is one of the most free, flexible, and open in the world. Our telecom, transportation, and utility systems deliver dependable service. Our talent pool of scientists and our university research facilities are second to none. Entrepreneurs can obtain financing for their ideas and intellectual property protection once they are developed. Relative to many other systems of government, ours is transparent, predictable, and dedicated to the rule of law. Our domestic market is the largest in the world. Those inherent advantages of doing business in the United States cannot always be offset merely by lower labor costs elsewhere and are especially important in those aspects of production that require creative freedom and specialized skills.

U.S. companies are also discovering the limits to outsourcing. There are perfectly good, market-driven reasons why U.S. companies will continue to do most of their IT work onshore if not in-house. Foreign outsourcing can generate costs of its own, such as the need for more travel, training, and management oversight. Depending on the type of project, those costs can eat into if not entirely erase the costs savings from lower wages abroad. Sending work abroad can also risk the loss of control of sensitive personal and financial data and copyrighted material. It can mean the loss of control over time-sensitive aspects of a project or becoming too reliant on outside firms. As some U.S. companies have discovered, it can result in reduced quality of service if the providers are not sensitive to cultural differences or lack specialized information expected by customers.

The phenomenon of foreign outsourcing creates tangible benefits for the U.S. economy and American workers. Whatever negative impact it has had on specific firms and workers has been limited and is far outweighed by the benefits.

1. U.S. Department of Commerce, Economic and Statistics Division, *Digital Economy 2003*, December 2003, p. 22, www.esa.doc.gov/DigitalEconomy2003.cfm.
2. Ibid., p. 20.
3. Ibid., Appendix Table 1.2.
4. Ibid., Appendix Table 2.4.
5. Ibid.
6. Ibid.
7. Ibid.
8. Daniel E. Hecker, "Occupational Employment Projections to 2012," *Monthly Labor Review* 127, no. 2 (February 2004): Table 2, p. 83.
9. Ibid., p. 98.
10. U.S. Department of Commerce, p. 23.