CASE STUDY

Is Job Outsourcing Good or Bad for Developing Countries?

In the past several years, multinational companies based in developed countries have increasingly turned to developing countries to carry out some of their business activities. This phenomenon, loosely called *outsourcing* or *offshoring,* is the transfer of some aspect of a company's business activity to another company in another country.[1] Typical outsourced business activities include data entry, accounting, and information technology support. Even tax returns are being processed by foreign computer operators.[2] These forms of outsourcing have helped create tens of thousands of jobs in some developing countries. At the same time, however, fears have grown among workers in developed countries that their jobs could be outsourced.

Outsourcing is not a new development in the global economy. Pankaj Ghemawat, a Harvard Business School professor, traces its roots to whaling fleets and floating factory ships of the late eighteenth century.[3] Economist Arthur T. Denzau describes the more recent example of Motorola in the 1960s, when the company outsourced its labor-intensive assembly process to Malaysia, Korea, and Monterrey, Mexico. As is often the motive for outsourcing, the move allowed Motorola to compete effectively with other firms in the United States and, later, Japan.[4]

The scale of outsourcing in the past few years dwarfs the levels witnessed in previous eras. Thanks to advances in computer and communication technology as well as globalization in general, job outsourcing is now much more prevalent than ever, involving large numbers of both developed and developing countries. For example, many American companies have outsourced jobs to China and elsewhere. British banking firms have outsourced jobs to India. German companies have outsourced accounting jobs to Poland. Some Japanese companies have shifted operations to northeastern China, where Japanese is spoken.[5] Outsourcing is such a worldwide phenomenon that India, the global leader in outsourcing business, now faces competition from many other parts of the world, including elsewhere in Asia and even the East European countries that joined the EU in 2004.[6] Typifying the controversial nature of job outsource, Perrier, the Swiss-owned mineral water company, set off a political storm in the small town of Vergeze, France, when it threatened to move to lower-cost locations.[7]

Despite the growth in outsourcing around the world, or perhaps because of it, opposition has grown significantly in many developed countries. In the United States, for example, the former chief executive of Intel, Craig Barrett, believed U.S. workers face the prospect of 300 million well-educated people in India, China, and Russia who can "do effectively any job that can be done in the United States."[8] For opponents of outsourcing, the problem is not just low-tech manufacturing jobs; more and more high-paying, white-collar service-sector jobs are being outsourced as well. According to Deloitte Research, two million financial-sector jobs could be outsourced by 2009.[9] As journalist Eduardo Porter put it, "The worldwide pool of available well-trained workers is much larger, and they are only a mouse-click away."[10]

This case study, then, taps into many issues raised in this chapter and in chapter 12. The expansion of outsourcing around the world highlights the interdependent relationship of developed and developing countries. The case discusses the potential costs and benefits for both categories of countries. The first section looks at the arguments for and against outsourcing in developed countries. The outcome of the debate among developed countries is of paramount importance to many developing countries that count on the foreign investment and jobs that derive from outsourcing. In developed countries, political pressure from labor unions and a public nervous about their jobs being "exported" has led to protectionist measures. Developing countries that benefit from outsourcing, thus, pay close attention to the political dynamics of the United States.

The second section looks at the consequences of outsourcing in developing countries. Outsourcing by multinational corporations has both economic and political implications for developing countries. These implications raise interesting questions for the theories presented in chapters 12 and 13. For example, is outsourcing, as a Marxist might expect, simply another tool for rich, capitalist countries to exploit their own lower-skilled workers as well as the poor workers of periphery (developing) countries? Or, as liberal economists might say, is outsourcing beneficial to workers (as well as consumers) in both developed and developing countries? If one includes social and cultural factors in the definition of *development,* as many sociologists and anthropologists do, then should outsourcing be viewed favorably or as something to eliminate? Regardless of the answers, outsourcing is probably here to stay. The question is whether this is good or bad for developed and developing countries alike.

The Case for Developed Countries

With the decline in manufacturing in developed countries, jobs have become harder to sustain, and people have increasingly looked to outsourcing as one major source of the problem. During his presidential campaign in 2004, for example, John Kerry referred to the chief executive officers of companies that outsource as "Benedict Arnold CEOs" for outsourcing American jobs.[11] This view is partially supported by the findings of a 2002 study conducted by the Forrester research firm which concluded that 3.3 million white-collar U.S. jobs—including 500,000 information technology jobs—will shift offshore to countries by 2015 at a cost of over $136 billion in wages.[12] So the potential stakes are huge. Despite these concerns, raised by unions, interest groups, and the media, supporters of outsourcing supply considerable evidence that the United States, Japan, Britain, and other developed countries benefit from it. Just as liberal economic theory would predict, outsourcing should lower prices in the United States, which, in turn, will raise the buying power of U.S. consumers. With the resulting higher consumer spending and increased economic activity, more jobs should be created. Similarly, if job outsourcing to developing countries improves their economies, consumers in developing countries should demand more U.S. exports.[13]

For many companies, outsourcing is vital. As Columbia University professor Jagdish Bhagwati explains, companies that do not seek cheaper supplies of services in developing countries "are doomed to lose markets, and hence production. And companies that die, of course, do not employ people."[14] The outsourcing of jobs is not necessarily a zero-sum game in which developed workers lose out to workers in poor countries. For example, Delta Airlines outsourced 1,000 call center jobs to India in 2003, saving $25 million in the process. With those savings, however, Delta was able to add 1,200 reservation and sales positions in the United States.[15]

Even though the widely accepted figure of 3.3 million lost jobs to outsourcing sounds distressing for U.S. workers, University of Chicago political scientist Daniel W. Drezner points out that 3.3 million lost jobs translates into only 220,000 jobs lost to outsourcing *per year*. That's a small number compared to the number of jobs in the overall U.S. economy: 130 million. Thus, outsourcing should affect less than 0.2 percent of employed Americans each year.[16]

According to N. Gregory Mankiw, former chairman of the president's Council of Economic Advisers, outsourcing helps American companies stay profitable and improves their productivity. According to Robert Reich, who served as labor secretary under President Bill Clinton, "outsourcing does not reduce the total number of jobs in America. If other countries can do something cheaper we ought to let them do it, and concentrate on what we can do best."[17] Catherine L. Mann of the Institute for International Economics, a Washington research group that backs free trade, calculated that lower costs due to globalized production accounted for 10 percent to 30 percent of the decline in hardware prices during the technology boom of the second half of the 1990s, when computer prices fell 10 percent a year. Moreover, the U.S. GDP grew by $230 billion between 1996 and 2003, thanks to outsourcing of information technology production.[18]

Interest groups that back American workers—such as Rescue American Jobs, Save U.S. Jobs, and the Coalition for National Sovereignty and Economic Patriotism—are pressuring the federal government to stem the flow of jobs overseas. If the U.S. government decided its workers needed protection and investment in developing countries dropped, those countries would be significantly affected. Would such a move be viewed positively or negatively in developing countries?

The Case for Developing Countries

By the start of the twenty-first century, *outsourcing* was a household word in many countries around the world. Most of the press reports in developed countries, however, highlighted the potential risks to jobs and not the potential benefits to developing countries. This changed, in part, because of reporting by *New York Times* columnist Thomas L. Friedman, who looked at the impact of outsourcing not only on the advanced countries but also on the developing countries, especially India.

One of the most interest findings from Friedman's study of Indian call centers that do work primarily for American companies is how Indian business can be good for the United States and its workers. "How does [outsourcing] benefit the U.S.?" Friedman asked S. Nagarajan, the CEO of a company called 24/7. The CEO replied, "Well, look around this office." All the computers were from Compaq. The basic software was from Microsoft. The phones were from Lucent. The air conditioning was by Carrier, and even the bottled water was by Coke, because when it comes to drinking water in India, people want a trusted brand. On top of all this, Nagarajan added, 90 percent of the shares in 24/7 are owned by U.S. investors. This explains why, although the United States has lost some service jobs to India, total exports from U.S. companies to India have grown from $2.5 billion in 1990 to $4.1 billion in 2002. As Friedman puts it, what goes around comes around, and also benefits Americans.[19]

Friedman also raised awareness of the complexities of outsourcing, of how it is difficult to draw definitive conclusions about its costs and benefits. For example, Friedman found that a lot of "America's Saturday morning cartoons are drawn by Indian animators like JadooWorks, founded several years ago here in Bangalore, India, though, did not take these basic animation jobs from Americans.

For twenty years they had been outsourced by U.S. movie companies, first to Japan and then to the Philippines, Korea, Hong Kong, and Taiwan.[20] The sophisticated, and more lucrative, preproduction, finishing and marketing of the animated films, though, always remained in America. Indian animation companies took the business away from the other Asians by proving to be more adept at both the hand-drawing of characters and the digital painting of each frame by computer—at a lower price. . . . But here's where the story really gets interesting," Friedman added. "JadooWorks has decided to produce its own animated epic of the life of Krishna. To write the script, though, it wanted the best storyteller it could find and ended up outsourcing the project to an Emmy Award–winning U.S. animation writer, Jeffrey Scott—for an Indian epic! [An] Indian cartoon company isn't just taking American jobs, it's also making them."[21]

India, of course, is not the only target for outsourcing business activities. Top outsourcing countries include China, Malaysia, the Philippines, Brazil, Mexico, and the states of Eastern Europe. In Poland, for example, experts believe outsourcing will give a huge boost to employment. As foreign investment gathers momentum in Poland, the number of posts in outsourced business services could rise from about 3,000 in 2004 to 200,000 by 2008.[22]

Jobs created by outsourcing in developing countries are not just low-end, low-skill jobs. Samir Chatterjee, an associate professor of information science, offers a striking example. "Companies that want to outsource aren't just looking for cheap labor. In the Indian city of Bangalore, for example, there is a Jack Welch Technology Center which is designing the next jumbo jet."[23]

On a more personal level, Friedman explains how outsourced jobs in India are important to the individuals who get them. "These are young college grads, most of these kids, who aren't engineers. They could never get jobs, not for $200 to $300 a month, which is the starting pay in a call center, without this opportunity. And what this has given them is really a chance to grab the first rung of the ladder. A lot of them on the side are studying for MBAs or other college degrees. Some of them are now supporting their family. For many of them, their starting salary is more than their parents' retiring salary."[24]

According to some supporters of outsourcing, these economic benefits are also linked to political benefits. Friedman, for example, believes the United States has a strong interest in rewarding developing countries that reduce barriers to U.S. trade and investment. Not only will it help their economies, but some countries that benefit from outsourcing are also vital allies in the war on terrorism.[25] From Friedman's perspective, an improving economy—fostered, in part, by outsourcing—can create young workers with more self-confidence, dignity, and optimism. He contrasts the positive and optimistic outlook of workers in India to the attitude held in many parts of the Middle East, where people often have "no hope, no jobs, and no dignity." A stark example is drawn from a conversation with three young workers he spoke to in the Palestinian West Bank. They "each nodded when one of them said they were all 'suicide bombers in waiting.'"[26]

Outsourcing, of course, is not admired by everyone in the developing world. Critics complain about the loss of local cultures and the stresses of the fast pace of life engendered by globalization. In Friedman's study of outsourcing in India, these views were expressed by several interviewees.[27] Abraham Varghese, a former business executive, argues that the majority of Indians live in villages away from the cities, places where life seems a hundred years behind the times and untouched by any so-called benefits of outsourcing. He worries that globalization—facilitated, in part, by outsourcing—is actually causing villagers to lose what little they have. In one instance, he describes Indian women who made incense sticks as a cottage industry. But when a company called British American Tobacco Brand began to make and sell incense, these women could not compete. "It is criminal," Barghese complains, "to deprive these people so that this company can add a little more profit."

Madhu Bhusan, an anti-globalization activist, argues that outsourcing and globalization in India are "creating a dependence and creating a vacuum in the kind of natural organic nature of our society." The city, she complains, "has become the model of development, progress, of economic growth, of everything . . . and economic conditions in which village life becomes unsustainable." What's more, the idealized view of globalized lives masked the sense of cultural loss prevalent in so many villages throughout India. K. L. Kumar also seeks the preservation of traditional life in India. "Let the industry economies live, but leave us alone. Don't make us want to live like you."

Notes

1. More precisely, when a company *outsources* the supply of products, services, or component parts, it delegates them to a third-party provider, whether abroad or at home. With *business process outsourcing,* a company outsources an entire business process (e.g., accounting or human resources) to a third party. "Offshoring" occurs when a company relocates processes or production to a lower-cost foreign location in the form of subsidiaries or affiliates. See Rammohan Rao, "How to Tap the Opportunities for Outsourcing," *Financial Times,* August 25, 2004.
2. Michael Skapinker, "Use Your Hands Instead of Your Head for Job Security," *Financial Times,* October 6, 2004.
3. "Relocating the Back Office," *The Economist,* December 13, 2003.

4. Brian Schneider and Marilyn Thomsen, "Outsourcing: Bane or Blessing?" *The Flame* (Claremont Graduate University, Summer 2004), 16–20.
5. "Local IT Firms Set Sight on Japan Outsourcing Job Market," *Financial Express,* http://www.bhuivan.com/, September 7, 2004.
6. For information on India's concern about new EU member states, see Afzal Akhtar, "India Challenged! New EU Members Join the Outsourcing Race," *India Daily,* http://www.indiadaily.com/editorial/09-27f-04.asp, September 27, 2004.
7. Jo Johnson, "Threatened Relocation Worries Town Dependent on Perrier Plants," *Financial Times,* September 18, 2004.
8. Jagdish Bhagwati, "Why Your Job Isn't Moving to Bangalore," *New York Times,* February 15, 2004.
9. As quoted in Daniel W. Drezner, "The Outsourcing Bogeyman," *Foreign Affairs,* 83, no. 3, 24.
10. Eduardo Porter, "The Bright Side of Sending Jobs Overseas," *New York Times,* February 15, 2004.
11. Bhagwati, "Why Your Job Isn't Moving."
12. See "Relocating the Back Office; and Schneider and Thomsen, "Outsourcing: Bane or Blessing?"
13. Christopher Swann, "Moving Jobs Abroad 'Will Create Them in the US,'" *Financial Times.* April 2. 2004.
14. Bhagwati, "Why Your Job Isn't Moving."
15. Drezner, "Outsourcing Bogeyman," 27.
16. Ibid., 26.
17. Porter, "Bright Side."
18. In addition, according to Mann, outsourcing boosted productivity growth from 2.5 percent to 2.8 percent a year from 1995 to 2002, a gain that in turn added at least $230 billion to the country's total output of goods and services. Porter, "Bright Side." See also Drezner, 29.
19. Thomas L. Friedman, "The Silver Lining of Outsourcing Overseas," *New York Times,* February 27, 2004.
20. "Indian Finance Minister Says U.S. Anger at Outsourcing 'Exaggerated,'" *India News/AFP,* October 8, 2004.
21. Friedman, "Silver Lining."
22. Akhtar, "India Challenged!" For a summary of outsourcing in Poland, the Czech republic, Hungary, and Slovakia, see Stefan Wagstyl, "Budapest: The Next Bangalore? New EU Members Join the Outsourcing Race," *Financial Times,* September 21, 2004.
23. Schneider and Thomsen, "Outsourcing."
24. Terence Smith, Public Broadcasting System, http://www.pbs.org/newshour/bb/asia/jan-june04/friedman03-09.html.
25. Drezner, 30.
26. Thomas Friedman, "30 Little Turtles," *New York Times,* February 29, 2004.
27. The quotes in the text following this footnote are from the Discovery/Times documentary "The Other Side of Outsourcing," first aired in 2004.

Questions

Check Your Understanding

1. In what ways is outsourcing believed to be good and bad for developed countries?
2. In what ways is outsourcing believed to be good and bad for developing countries?

Analyze the Issues

1. How can opposition to outsourcing in developed countries affect developing countries in positive and negative ways?
2. How useful are economic liberalism and Marxism at helping us understand the political and economic dynamics of outsourcing?
3. If outsourcing is supposed to benefit developing countries, what if anything should be done for workers in developed countries who lose jobs to foreign companies through outsourcing?

Further Information

To find out more about the job outsourcing, consult the following sources:

Jagdish Bhagwati, "Why Your Job Isn't Moving to Bangalore," *New York Times,* February 15, 2004.

Daniel W. Drezner, "The Outsourcing Bogeyman," *Foreign Affairs,* 83, no. 3:22–34.

Thomas L. Friedman, "The Silver Lining of Outsourcing Overseas," *New York Times,* February 27, 2004.

McKinsey & Company is a management consulting firm that routinely conducts studies on outsourcing. Recent issues of *The McKinsey Quarterly*, for example, have included outsourcing articles on Brazil, Mexico, Chile, and Eastern Europe. See their website, http://McKinsey.com.

Outsourcing.org, http://www.outsourcing.org/.

"Relocating the Back Office," *The Economist,* December 13, 2003.

Stefan Wagstyl, "Budapest: The Next Bangalore? New EU Members Join the Outsourcing Race," *Financial Times,* September 21, 2004.