Outsourcing U.S. Jobs Abroad: Why?

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ABSTRACT

Although the United States is the world's biggest proponent of capitalism and free trade, the time has come to address what global economic pressures have done to America's labor force. From the Second World War to approximately the late 1990s, the U.S. labor market was robust and "full employment" without inflation appeared to be feasible. However, the rapid spread of global technology provided the means by which all resources, including labor, could be transferred or utilized around the world with ease. From the 1980's forward, the American government began to favor deregulation, less government regulation on business, as well as more favorable business taxes. From 2000 to the present, the U.S. government "encouraged" the exporting of American jobs to other countries that provided less expensive labor as well as other favorable political and economic incentives. This was done by passing favorable domestic tax legislation for those firms that wished to outsource production.

This paper addresses the dilemma that the U.S. economy now faces with high unemployment and its contribution to slow economic growth. Some of the economic, legal, and political factors that have encouraged the outsourcing of jobs are also addressed. A brief review of some of the suggested ways to help reverse U.S. job losses due to outsourcing is also explored.

Keywords: Insider Trading; Congressional Stock Trading; Congressional Ethics

INTRODUCTION

In the aftermath of the Great Depression, the Second World War provided full employment for America's labor force. When the war concluded, the United States provided finished goods and services to most of the free world and was blessed with the resources to do so. This reality lasted from approximately 1950 through 1980. The 1980's saw the beginning of a broad-based creation and implementation of technology. This improved economic productivity created an environment for less skilled labor. The American auto industry is a classic example where assembly workers were paid wages and benefits at levels that could later be easily undercut by lower cost automation. During the 1980's, the American government established itself on the platform of less government regulations, lower taxes for business and individuals, and the call for less government spending. This public policy became known as "Reaganomics." During this period, the federal administration also promoted deregulation of America's industrial economy and a stance against the membership of the air traffic controllers. This appeared to mark the early beginning of a slow decline in union membership nationwide. The 1990's was more or less a magnification of the 1980's with the U.S. economy reaching new heights of prosperity in productivity, economic output, full employment, employment, as well as price stability. This was mostly encouraged by significant advances in applied technology. The political tenor of the 2000's was focused on further reductions in taxes that "encouraged" the outsourcing of production and U. S. jobs, further business deregulations, and increases in government spending. In addition, the economic volatility of the 2000's was exacerbated by the 911 terrorist attacks and the 2008 financial meltdown. The above events put additional negative pressure on corporate financial statements and precipitate the need to further reduce production costs. Hence, the above events encouraged stepped-up emphasis on exporting U. S. jobs abroad in an effort to reduce costs and attempt to improve business profits.

THE MACRO ECONOMY AND PRODUCTION COSTS

As was discussed earlier, the beginning of the last decade was riddled with a volatile U.S. economy. The 2008 recession caused many American companies to focus on cost cutting to salvage their profit margins. At the center of the production cost cuts was the domestic labor force where 500,000 American jobs were eliminated while 729,000 workers were hired overseas. Jack Welch, the past CEO of GE, was quoted as saying ". . . companies should seek to lower costs and maximize profits by moving operations wherever is cheapest." It is not just cheaper labor costs that are motivating U.S. firms to exports jobs. Offshoring can reduce the level of workplace and environmental regulations (The Week, 2011).

OUTSOURCING AND THE U.S. ECONOMY

In general, outsourcing that has become prevalent over the last several years has been the shifting of menial U.S. jobs to China and other low labor cost countries, while domestic administrative jobs have remained (Colvin, 2005). Irrespective of the popularity of outsourcing, it is hurting the U.S. economy directly and indirectly. Not only are many of the menial jobs being exported, foreign students that once opted to stay in America after graduation are now going back to their home country (Shao & Smith, 2007). Outsourcing has contributed to the current high domestic unemployment. According to J. Hay & M. Fricker, "when labor and manufacturing jobs are outsourced, individuals, families, and communities suffer economic losses due to limited job replacement" (Hay & Fricker, 2004). According to Shao and Smith, we continue to see several cases where U.S. educated foreign nationals leave America after graduation and accept work with a foreign-based U.S. firm. Martin Schmidt, associate provost at Massachusetts Institute of Technology, stated the following about the American labor pool in reference to the skill set needed to be employed at Apple Computer Corporation:

American companies say they need engineers with more than a high school education but not necessarily a bachelor's degree. Americans at that skill level are hard to find, executives contend. There are good jobs available, but they require certain skills; however, the country doesn't have enough skilled labor to feed the demand.

Lawrence Katz, an economics professor at Harvard, asks the following: ". . . will someone in his 40's have the skill for a middle class job, or will he be bypassed for a new graduate and never find his way back into the middle class?" (Katz, 2012) The questions and concerns are perplexing and suggest that the outsourcing of American jobs is complex and not just about cheaper labor abroad. The authors argue that the low skill levels of American high schools students is woefully subpar compared to other developed nations worldwide and is a contributor to outsourcing. In the past, the lack of skilled American labor has caused some U.S. firms to hire skilled foreign students who studied in the United States. However, it has been less convenient over the last several years because those workers find better total compensation in their home country. In addition, it has become more difficult for foreign job seekers to get U.S. work visas (Duhigg & Dradsher, 2012).

WHY OUTSOURCING IS POPULAR WITH AMERICAN BUSINESS

While lower wages is often used as the primary reason to outsource, there appears to be several other reasons why American businesses are enticed to ship jobs abroad. Surveys from several data gathering sources reveal that there are at least ten potential reasons why American business has become so enamored with outsourcing jobs (and it is not just because of cheaper labor) to China, India, and South America. Seemingly prompted by the evolution of globalization, a list was condensed and summarized by a survey researched by *Billshrink* - lower wages, less regulatory costs, tax benefits, ability to downsize at will, risk management, quicker turnaround time, uncertainty over political/business climate, accelerated time to market, commodification, and contractual certainty (Billshrink, 2011).

Lower Wages

Simply put, wages for manufacturing jobs in the U.S. are generally more expensive than the vast majority of developing countries and are likely the most attractive rationale for outsourcing American jobs. It is estimated that workers in China are willing to work for approximately one-fourth of the amount of comparable U.S. workers, while workers in Mexico, on average, are paid $2.65 per hour. Disparities, as described above, encourage many American companies to build their production plans around outsourcing. This is good business according to Milton Friedman, a past senior economist at the University of Chicago. In his book *Capitalism and Freedom*, he states, "there is one - and only one - social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engage in open and free competition without deception or fraud" (Friedman, 1970). While Friedman's opinions may seem firmly stated and subjective, many 21st century U.S. business executives seem to embrace Friedman's general feelings and find cheap labor and more profit a compelling reason to consider manufacturing overseas.

Less Regulatory Costs

The regulatory compliance cost for employing domestic labor can be a potentially bigger component of total worker cost than wages, per se. Examples of these costs or taxes on business include social security, Medicare, FICA, OSHA compliance, unemployment insurance, etc. When U.S. businesses consider outsourcing to China, India, or Mexico, the above labor expenses can be avoided.

Tax Benefits

Several foreign countries, anxious to lure American jobs to their shores, offer enticing broad tax incentives to U.S. multinational firms. In addition, large U.S. corporations with offshore subsidiaries can utilize the "unrepatriated earnings" benefits or revenues left in the outsourced country. These earning are not taxed by the United States government, which has allowed firms like Exxon, Apple, IBM and others to pay much lower income taxes than they would have normally.

Ability to Downsize at Will

Downsizing or upsizing at will provides American business managers with flexibility when addressing product demand. However, the *Dallas Business Journal* noted in 2007 that downsizing has the potential to increase the amount of law suits brought about by laid-off American workers. Lawsuits can bring implicit and explicit costs to corporate earnings which can be significantly reduced in foreign labor environments.

Risk Management

According to HorizonTech.com, outsourcing "enables management to turn over to its suppliers certain classes of risks, such as demand variability and capital investments." "This risk is most difficult with the employment of "in-house" employees and also means that full-time American workers must be paid Social Security, FICA, etc. – not the case with outsourced workers. In addition, outsourced workers can be dropped immediately if certain projects are not paying for themselves. By contrast full time "in house" employees usually cannot be laid off as easily.

Quicker Turnaround Time

For business, in general, but especially for smaller firms, when a decision to expand has been made, companies usually need to interview, hire, and train new employees. This takes time (and can provide slippage in new product development and marketing). By contrast, outsourcing is often faster and less expensive (in terms of time and money).

Uncertainty over Political/Business Climate

Uncertainty about the political/economic legislation coming out of Washington is frustrating for American business and makes it difficult to pursue long-term capital expenditure. *Information Week's* 2008 survey revealed that 25% of American corporate CFOs believed that "uncertainty about the political and business climate" was why they opted to outsource.

Accelerated Time to Market

Outsourcing allows U.S. companies to access workers who, for the most part, are already trained for jobs that businesses may need. This could not only save money but it can allow American corporations to get to market earlier than if they attempted to interview, hire, and train domestic employees for the same job. The result is often an accelerated time advantage for firms to be first to market.

Commodification

Large pools of outsourced venders can reduce labor costs – or allow for the commodification of physical resources. This has been one of the advantages that multinational firms have exclusively enjoyed, but it is now available to smaller companies. In addition, this also provides an opportunity for small businesses to grow faster than if they had to rely on hiring and training their force. Finally, according to SmallBizTrends.com, it saves small business the potential costs of regulatory taxes as discussed earlier.

Contractual Certainty

Finally, outsourcing can provide an understood legal contract (which can compensate companies for potential under-performance, negligence, and/or job failure) between the firm and the vender. This is difficult, if not impossible, when "in-house" employees are utilized.

The above 10 reasons why American businesses find outsourcing attractive is referenced from *Billshrink*.

An important observation of the above is that the decision to outsource jobs abroad is complex and not just based on the quest for less expensive wages, per se. It involves other factors that have simply evolved from the evolution of globalization itself. Therefore, an attempt to reverse the outsourcing trend may be more intricate and complex for the U. S. government than can be managed with legislation that has been passed thus far.

WASHINGTON'S RESPONSE TO OUTSOURCING

In President Obama's recent State of the Union address, he provided a *Blueprint for an America Built to Last*. The President's speech was partially aimed at encouraging U.S. companies to create manufacturing jobs in the United States, while discouraging outsourcing.

The President's proposals for reversing American's job drain consisted of six recommendations to encourage job growth in the U.S. He further stated that his proposals for job growth would be fully paid for by closing tax loopholes that encouraged manufacturing and revenue retention overseas. Finally, the President's proposals suggested an international minimum tax, lower tax rate for U.S. manufacturing at home, and a tax reform for American business in general.

The revenue-neutral job creation recommendations provided by the President in his State of the Union address to Congress are summarized below (Whitehouse, 2012):

1. Remove the tax deduction for companies that move their operations abroad, but offer a 20 percent tax credit for the expenses of moving operations back to the U.S.
2. Provide a tax incentive specifically for manufacturing domestically.
3. Implement a manufacturing tax credit to encourage job creation in communities that were affected by job loss.
4. Provide temporary tax credits that would be directed at creating new investments and increased jobs in clean air manufacturing.
5. Create a tax incentive that would allow American businesses to expense the full cost of investments in new plant and equipment which would provide tax relief of up to $50 billion for domestic business.
6. Eliminate any loopholes that encourage U.S. firms to transfer profits overseas.

If one compares the more popular reasons why American businesses outsource in the first place, to Washington's reaction to dissuading the exporting of jobs - especially manufacturing jobs - there are apparent gaps. More specifically, President Obama's proposals, while robust, seem to focus primarily on tax incentives. Of the ten reasons why American businesses decide to move abroad for manufacturing, only a few are related to tax reasons, per se. Therefore, one must as ask, "Are the core issues being addressed by Washington?" The authors don't think so and believe that the focus should be broader in scope and must include education as a central focus. Simply put, many of the current jobs available in the U.S. today, especially in high technology, go unfilled because American firms can't find qualified domestic workers. Hence, labor is sought elsewhere in the world.

IS THE LURE OF CHINA IN FLUX?

Data suggest that the wages for many Chinese workers, as well as shipping costs for goods back to the U.S., have been rising. By contrast, wages for American workers have remained relatively flat. In addition, there have been complaints from U.S. firms regarding poor quality and disregard for intellectual property rights from China. The battle to preserve copy rights and property rights appears to be on-going and often a losing battle for American companies. Farouk Systems, a major U.S. producer of hair dryers, states that the firm spends over $500,000 per month to stave off Chinese counterfeiters during the manufacturing process. There is more concern that if there is a problem with shipped goods from China, it can take a great deal of time to fix it. In addition, now that the Chinese government has been allowing their currency to rise against the dollar, it can drive up the cost of doing business in that country. Further, General Electric stated that it plans to bring certain types of manufacturing jobs back to the U.S., citing rising labor costs in China and lower inventory expenses and faster potential deliveries (Davidson, 2010).

UNSKILLED AMERICAN WORKERS AND OUTSOURCING

While it may be true that some U.S.-based firms have become disenchanted with the cheaper cost of doing business in China, the fact remains that America's labor force needs to be better educated if they are to compete in a global market. Recent data are not encouraging for the future of the American labor force. It shows that nationwide only 69 percent of students earn their high school diplomas. That is to say that 7,000 high school students drop out every school day across America. A breakdown of groups shows that 77% of whites graduate, followed by 56% Hispanics, 54% African Americans, and 51% American Indians. Hence, the ability for the U.S business sector to fulfill their need for highly skilled workers - now and in the future - will be a challenge. Based on a recent study conducted by the *Council on Foreign Relations,* "Americans going into the labor force today are less educated than those retiring from it. This phenomenon is unique among developed countries." The report goes on to state that ". . . as baby boomers (born in the generation after World War II) continue to leave the workforce, companies will have trouble finding skilled workers to replace them" (Brown, 2013). Unless the U.S. begins to produce more skilled workers to fill the current gap, American businesses will continue to seek workers elsewhere.

SUMMARY AND CONCLUSIONS

One can build an argument that after the mid-1980s, globalization set the stage for the mobility of resources around the world. Through the process of free trade, this allowed certain countries to purchase all types of resources, including labor from other countries, more cheaply than they could provide within their own country. As the American markets became saturated with imports, it became difficult for U.S. firms to increase their prices to maintain profit margins. Cost cutting, including job cuts and outsourcing, became a viable alternative. Job loss continued to rise in the aftermath of the great recession of 2008.

While cheaper labor abroad is likely the center of the decision to outsource for many U. S. companies, it is not the only reason. Countries like Ireland, China, and India entice American business to manufacture in their country with specific tax and regulatory benefits that are not available in the U.S. In addition, the America government, to some degree, encourages domestic firms to outsource by allowing outsourcing expenses to be deducted from U.S. taxes. The U.S. government is aware of the problem and is trying to address it. However, Washington's, proposed solutions to reverse the outsourcing of American jobs appears to be focused on tax incentives. In the authors' opinion, Washington's efforts to date are too focused on tax reductions and not enough on the longer term solutions.

The authors believe that while tax and other incentives are important to business for the short to intermediate term and can help reverse outsourcing, the longer term solution must include more education for

America's labor force. Because of the magnitude of the problem, it would need to necessitate the coming together of labor, business, and government at a national conference level.

Federal government policy is currently embodied in a strategy of emphasizing education, infrastructure, innovation, and existing benefits such as intellectual property protection (Mehlman, 2003). It is the authors' view that employers, as well as the state and federal governments, must stop advocating and supporting outsourcing of U.S. jobs. Visa, immigration, and tax laws that support outsourcing must be rewritten.

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