

Policy Responses to Outsourcing: First, Some Facts on Its Impacts

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Introduction

- A framework for how outsourcing high-skilled labor might impact American workers.
- Two historical facts: counting jobs created.
- Two recent facts: unemployment and wages of more-skilled Americans.
- Another recent fact: productivity of all Americans.
- Some political-economy facts that give me most worry.

A Framework for Outsourcing

- Consider a U.S.-based investment-banking firm.
 - Suppose that in response to a fall labor costs abroad, it decides to relocate some of its banking activities to India.
 - What happens to labor demand in the firm's U.S. operations?
 - *Substitution effects*: If U.S. labor and Indian labor are price substitutes (or complements) in the firm's cost function, then a fall in Indian labor costs leads to a decrease (or increase) in U.S. labor demand.
 - *Scale effects*: If falling labor costs in India lead to an expansion in firm scale, then demand for U.S. labor may rise (even if U.S. labor and Indian labor are price substitutes).
 - *Scope effects*: If falling labor costs in India lead to an expansion in firm scope (holding scale constant), then U.S. labor demand may fall or rise depending on the labor intensity of the new lines of activity.

Two Historical Facts

- During the decade of 1991 through 2001, for every one job that U.S. multinationals created abroad in their affiliates (over 2.8 million) they created nearly two U.S. jobs in their parents (about 5.5 million).
- During that same decade, employment in U.S. parents grew faster than it did economy-wide. By 2001 parents accounted for a larger share of total U.S. payroll jobs (17.8%) than in 1991 (16.6%).
- *In recent years, U.S. multinationals have been a major force behind U.S. job creation, not destruction (See my 2004 report at www.cfitnet.org).*

Two Recent Facts

- If outsourcing has been different the past few years, then we might expect its pressures to appear first in the *economy-wide* performance of more-skilled U.S. workers.
- Fact: since 2000 the incomes of more-skilled Americans relative to less-skilled Americans have continued to climb (as since late 1970s).
- Fact: since 2000 unemployment rates have remained much lower for college graduates.
 - March 2004: 2.9% for CGs vs. 8.8% for HSDOs

An Additional Recent Fact

- Since 1995 growth in labor productivity—and thus real income and U.S. living standards—in the United States has accelerated markedly.
 - 1973-1995 annual average rate: 1.35%.
 - 1995-2003 annual average rate: 3.00% or more.
- IT firms have been at the core of the productivity boom: both via better *production* of IT firms and via greater *use* of IT elsewhere.
- These highly successful IT-producing firms are among the most globally engaged firms in the U.S. economy (see Slaughter 2002 at www.ecattrade.com; Mann 2003 at www.iie.com; and others).

The Political Economy of Globalization

- A plurality to majority of Americans *oppose* freer trade, immigration, and FDI.
- These preferences cleave strongly across labor-market skills: less-skilled Americans are much more likely to oppose liberalization.
 - If an “average” American goes from 11 years of education to 16, the probability s/he opposes trade liberalization falls by about 30 percentage points (Scheve and Slaughter, 2001 at www.iie.com).
- So will support for globalization wane if its pressures via outsourcing switch towards the more-skilled? The current signs are not encouraging.

The Political Economy of Globalization

- NBC News/Wall Street Journal national poll, March 2004.
 - “I’m going to read you a list of elements of the U.S. economy that have been discussed a lot recently. For each one, please tell me how important this item is to you in your evaluation of the overall condition of the economy.” #1 response: “the number of jobs moving overseas”.
 - And the most common prognosis for this response: “[This] represents a major problem today and in the future. American no longer has the same economic security it had in the past.”

Conclusions

- The forces of globalization increasingly shape national labor-market outcomes. This will change only if governments intervene (not impossible).
- Impact on globally engaged firms and their workers?
 - For firms, especially multinationals, the widening ability to produce and sell in many markets is a competitive opportunity.
 - For workers, the direct impact is less certain. It will depend largely on whether the global evolution of their employers make them more or less productive—and thus valuable.
 - In the longer term, the answer to this question increasingly depends on what skills U.S. workers offer relative to workers worldwide.
- How will the economic evidence on outsourcing shape the ongoing political-economy discussions?