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Out-sourcing and Privatization: Creating Value at What Cost?

Presenter: Dwight A. Sheldon, is presently a PhD candidate at Northcentral University in Prescott Arizona. Previously, he received an MPA from the University of Guam as well as a BA degree in Anthropology from the University of Florida.

Mr. Sheldon has contributed to research and development projects in Micronesia, Pacific Asia, Melanesia, Polynesia, and North America. In addition to his work on archaeological research projects and ethnographic studies on Guam and in the Northern Marianas Islands, he has worked on development projects related to agriculture in the Visayan Islands of the Philippines. Mr. Sheldon has authored, co-authored, and edited more than two dozen non-published technical reports of archaeological work including the benchmark studies, *An Archaeological Report on Miyama Hills, Guam* (1990) as well as *An Archaeological Assessment of Kagman/As Matuis, Saipan, CNMI* (1991). Mr. Sheldon worked for the Government of Guam (1992-96) as staff to three commissions including the Territorial Land Use Commission and the Territorial Seashore Protection Commission. He additionally supported review of infrastructure project and development applications before federal agencies throughout much of Micronesia. Mr. Sheldon is presently engaged as a consultant with Protec-services.com in Florida.

Abstract

This report examines aspects of one form of privatization: Out-sourcing. The paper treats aspects of recent national publicity about the “off-shoring” of American jobs and displacement of workers in the US. The presentation promotes an informed stance on many perceptions about the loss of American jobs in a competitive global economy. Discussion of the contention that corporate tax codes need revision in order to protect American jobs, plus facts on how many jobs are lost due to outsourcing is provided. Lastly, this discussion shows how out-sourcing has actual benefits for American business and consumers in a greater global economy.

Introduction

Out-sourcing was once viewed differently from how it is seen in the context of current business practices and in a newer, global economy. At one time, out-sourcing was considered to be a last-ditch effort that troubled companies looked to in order to solve the problems of their “bottom lines.” Much more recently, out-sourcing has become recognized as the strategic management tool that it is, allowing companies of all sizes to remain centered on their core functions and their core competencies. Smaller companies have moved to out-sourcing for not only the completion of peripheral tasks but also to handle multiple tasks that are tied directly to their core function.

Through out-sourcing, a company can work with those players that are most competent to perform specific functions so tasks can be preformed at a greater level of quality and can often cost less than if the company had attempted to do the work itself. Out-sourcing can save money and can allow companies to better utilize resources. Companies can have smaller workforces that do not require the additional administrative tasks inherent in a larger organization (Ivancevich, Lorenzi, Skinner, Crosby, 1997).

Out-sourcing to offshore companies has garnished a new standing in the business world: Recent debate on the topic has placed out-sourcing in the national spotlight. Because of the ideal that “off-shoring” acts to displace workers here in America, out-sourcing has gained a reputation as being bad for the Unites States. Certainly, savings in cost related to labor can be realized when the most competitive provider is utilized. The issue of added value is weighted by the matter of extraneous and societal costs, an issue actively debated in recent political campaigns.

OFF-SHORING AND THE RHETORIC OF CAMPAIGNS

While the purpose of this paper is not intended to be centered on aspects of the political process enshrined in the course of presidential elections, discussion of how that process has effectively created a greater public interest in off-shoring is necessarily in order. Among the most contentious issues of the recent campaign was that of out-sourcing work overseas and the subsequent threat to jobs in the US. During his 2004 presidential campaign, Senator John Kerry actively promoted the premise that the corporate tax code was largely responsible for the problem of sending American jobs overseas. The senator announced that he had a plan to remedy much of the problem. In key battleground states and in those states in which there had been substantially high levels of unemployment, Kerry made this issue the cornerstone of his campaign.

Additionally and to fuel the rhetoric of debate, Kerry often placed the blame for much of the problem of unemployment caused by off-shoring on the actions of his opponent, George W. Bush. Many of the party loyal picked up on the mantra while others, inside and outside of the party, suggested that out-sourcing jobs overseas was a minor problem and that Kerry's plan would accomplish very little in correcting it.

President George W. Bush actively contested Kerry's controversial proposal. The President continues to not support the senator’s plan; the Bush administration supports measures that allow US-based multinationals a larger tax credit on their overseas income. While Democrats argue that such a plan would only increase incentives to move jobs overseas, the administration counters that its own approach would help US firms compete globally with foreign firms that are able to otherwise avoid US taxes altogether.

Senator Kerry had announced his plan to keep jobs in this country through a new economic plan for America. In part, the plan called for ending tax incentives that encourage American companies to send jobs overseas.[1] As presently allowed, corporations would still get a credit for any taxes paid in other countries. However, Kerry had proposed a tax immediately upon foreign income: businesses would no longer be able to defer the US taxes indefinitely.

Kerry proposed that the corporate tax rate be cut by 1.75 percentage points, to a top corporate rate of 33.25 percent. Kerry would have allowed a one-year "tax holiday" to allow businesses to avoid US taxes on repatriated earnings that would otherwise have been left overseas. The senator would also offer a tax credit to companies when they choose to hire workers in the US rather than out-sourcing jobs overseas.

In sync with any rhetoric planned to tug on the emotions of the electorate, one must state the certainty of the very human toll of off-shoring jobs. Before attempting a discussion that

[1] The plan additionally called for increases in education and for investments in new technologies (such as alternative fuel sources) that would create jobs in this country.

may appear unattached to the real anguish of those persons who have lost jobs or that might lose a job in the future, this writer wishes to acknowledge that such loss is regrettable. To any person, family, or community that must deal with the consequences of the loss of even a single job, off-shoring must necessarily seem to carry substantial and irrefutable costs.

As an engaged electorate continues to assimilate the differences in rhetoric between each camp, their representatives on Capitol Hill have begun a continued debate. Beyond the publicity gained during the campaigns, perhaps the single greatest effect of the exchange on American jobs and corporate taxes was that a fully engaged legislative branch continued the debate on the equity of tax codes and of the plight of the American worker. American lawmakers continue to debate the practicality and the possible ramifications of making specific changes in the code.

BEYOND CAMPAIGN RHETORIC: CONGRESSIONAL DEBATE ON CORPORATE TAXES

Moving past all the campaigns, the assertion that American businesses are “off-shoring” jobs merely to avail themselves of advantageous tax codes has some merit: There is indeed a tax break for US-based multinational corporations to conduct operations overseas. However, no seated president can be blamed for the situation because the codes have existed in much of their present form for decades. In discussion of issues brought forward during the campaign—especially the matter of outsourcing American jobs overseas—some specific points may well be succinctly addressed to further a greater discussion of out-sourcing.

Much of the problem with the present tax code is centered in the fact that it has not kept pace with changes in the economy of the United States and in a newer global economy. US International tax policy is based on tax principles that were developed in the 1950s and 60s.

There are at least two kinds of out-sourcing relevant to this report and which are subject to existing or revised corporate tax codes. In one type, an American company closes a facility in the US and opens its replacement in a foreign country. This form of out-sourcing may or may not be planned to deliberately take advantage of the tax "loophole" and to defer US taxes. In this scenario, and since the American company retains ownership of off-shore operations, often choosing to reinvest income abroad, the company would be impacted by changes in the tax code.

A second type of outsourcing—the primary type to affect information technology (IT) workers—involves American companies subcontracting work (and displacing workers in the US) to off-shore companies. Since the hypothetical US company doesn't own the off-shore facility, the company doesn’t enjoy any tax break because it doesn't generate off-shore profits. In this type of out-sourcing, only deliberate incentives built into tax codes address the issue of the displacement of workers.

Some say that a plan similar to that which had been proposed by Senator Kerry would not accomplish much to solve the problem, or that such a plan could actually hurt American businesses and impede economic recovery. Some experts say that such a fix could actually send more jobs overseas as businesses seek to relocate abroad.

Tax incentives to increase retained earnings exist when the US corporate tax rate exceeds that of the country in which companies do business. Furthermore, the US also taxes income that US-based companies earn in other countries when such profits are repatriated to the US. Profits that remain invested overseas never get taxed at the higher US rates. Apparently, the corporate decision to retain income outside the US is becoming more prevalent, and the amount of unrepatriated foreign earnings is growing substantially. In a report last year, the non-partisan Congressional Research Service said that such earnings had increased to $639 billion in 2002 from $403 billion in 1999 (US House, 2004).

DOMESTIC EMPLOYMENT AND OUT-SOURCING

Many economic analysts state that out-sourcing jobs overseas is a fairly minor problem compared to the total picture of the unemployment situation. Most experts agree that elimination of the present tax break would not end the off-shoring of many American jobs. While many multinational businesses choose to not repatriate earning because of the allowed savings in tax burdens, there are other important reasons that propel work to operations abroad. Certainly, the fact of lower wages realized in many foreign workforces is an extremely important factor. In fact, the reduction in costs of utilizing foreign workforces alone is a very powerful incentive; yet, there are other reasons beyond tax breaks and wage differences that drive out-sourcing.

For one thing, customer services must follow consumers. In the global economy, a growing proportion of consumers of American goods and services live outside the US. Many companies rightfully strive to be near their global customers in order to best serve them.

Factors of the economics of a greater global marketplace alone help to drive out-sourcing. Off-shore companies that contract to perform services continue to make substantial strides in investing in forms of higher-level technology and processes (as well as training and human resources) that add value to quality-based products.

Additionally, foreign governments that are home to service-based companies have succeeded in putting reforms in place that are highly conducive to increased business activities. In India, for example, telecommunications costs in have dropped by 70 percent over the past several quarters (McDougal, 2005). Since the integration of countries from the former Soviet Union, Eastern European countries now contribute ever-increasing numbers of highly skilled workers to the global workplace. The World Trade Organization has welcomed the economic and labor-rich giant, China. Globally, many antiquated trade barriers have been dismantled.

Development-oriented policies by governments, in cooperation with industry, have helped to increase transportation and communications around the world. Plummeting relative transportation and communications prices have allowed workers to be able to join the ranks of higher-level workforces. In all, a newer, global economy has continued to grow by the recent addition of 300 to 400 million highly educated workers.

It its report, “Extended Mass Layoffs Associated With Domestic and Overseas Relocation, First Quarter 2004 Summary,” the Department of Labor concluded research on the matter of American jobs going overseas. The research found that out-sourcing jobs overseas accounts for a small proportion of the millions of American jobs that are lost each year. Of course, there are no official figures on the exact number of jobs that have moved overseas; yet, the Labor Department summary is one of the best sources of information on the impacts on labor as a result of off-shoring. The report looked at only those companies that lay off 50-or-more workers at one time for a period of 30 days or longer. The report indicates that only 2.5 percent of major layoffs in the first three months of 2004 were the result of off-shoring (Department of Labor, 2004).

One must be aware that the vast majority of jobs in the United States are those types that require geographic proximity to the end-user—jobs that produce goods and services that must be consumed locally. Such types of jobs include construction, agriculture, certain types of services, personal care and medical care, as well as restaurants and forms of entertainment and recreation. Out-sourcing these types of jobs overseas is not feasible. Other types of jobs that require production portions and processes that are fairly complex, interactive, or personal are relatively difficult to send abroad. Due to the sheer size of the American workforce and the number of workers employed in the above types of jobs, possible off-shoring would affect less than 2 percent of American workers.

Ben Bernanke, Governor of the Federal Reserve, has noted that the annual total number of jobs lost to "off-shoring" is approximately one percent of all jobs lost. He estimates that the US economy lost a total of about 15 million jobs each year over the past decade. At the same time, the same economy created an average of approximately 17 million new jobs each year. Bernanke said the portion of jobs lost to out-sourcing is quite small (Bernanke, 2004).

It is clear that off-shoring has had a relatively modest impact on unemployment when compared to all the other economic factors. Factoring in economic downturns, decreased demand, downsizing, streamlining, or other spoilers causing workers to lose jobs, the actual job loss resulting from off-shoring has been relatively minimal as a percentage of the total jobs lost in the United States.

Additionally, forms of improved productivity through the use of automation and improved processes (as well as through the availability of advanced forms of tools) are expected to continue to have the greatest impact on job creation and losses in this country. By the year 2015, the effect of those factors on IT-job displacement is expected to be six times greater than the impact of off-shoring (McDougal, 2005). Job losses from a greater level of productivity must be balanced by job creation—by newer types of industries that create and build such advanced tools, processes, and forms of automation.

Beyond the “bottom-line” loss of actual jobs, there are real costs to those American workers who have otherwise been able to hold onto their job. For several reasons, off-shoring contributes to wage levels that are stagnant and to benefits levels that are declining.

Off-shoring has the effect of forcing American workers to compete within a global economy with a workforce that continues to grow at a rate indicated by the recent addition of hundreds of millions of highly educated workers. Additionally, and due to practical management considerations, US workers find that the level of benefits provided to them is normally adjusted downward to more closely approximate the levels of benefits offered to workers in other countries. Presently, all workers do not enjoy benefits such as 401(k) plans and vacation pay. In some countries, there is less need for employer-paid health plans; yet, the health care system in the Unites States is relatively much more expensive than in other countries, so employer-subsidized health plans are more of a necessity.

THE UPSIDE OF OFF-SHORING

Conversely, recent studies show that when companies move some jobs abroad, the savings in costs stimulate job creation at home. Moving jobs overseas may have a direct short-term (adverse) consequence. Yet, in the long term, a greater global economy increases this country's total economic growth while increasing real wages and improving the national and global standard-of-living.

An examination of the amount of business that is out-sourced from other countries into the US shows a significant trade surplus in services, in contrast to a less-significant trade deficit in goods. In 2002, the US "in-sourced" nearly $29 billion in business while it out-sourced less than $11 billion. This shows an overall surplus of $18 billion (Bernanke, 2004). The US in-sources mostly high-value services from foreign users; yet, in contrast, it out-sources relatively less-valuable services (Bernanke, 2004).

CONCLUSION

A solution to any problem of out-sourcing that is based on tax amendment is extremely complicated and controversial. No would-be remedies can ever impose US taxes on income earned in another country; enforcement of any such provisions would be impossible. Additionally, many businesses would merely find new ways to delay or avoid taxes. For this and other reasons, much of the root of the problem of displacement can not be found in the tax codes.

It remains nearly impossible to measure exactly what factors drive off-shoring and which related factors exacerbate unemployment. Companies can rightfully continue to assert that the main reasons they locate plants in other countries are to be near foreign markets and to be able to provide a better quality product.

In fact, off-shoring accounts for a relatively small portion of US unemployment. There is no denying that off-shoring can displace American workers; however, it does not cause the tectonic shift that many persons ascribe to it. The effects of out-sourcing on the US and in industrialized nations tend to be disproportionately exaggerated in popular discussion by politicians.

The best way to view out-sourcing is to consider it a form of adjustment in the greater environment of a global marketplace. Certainly, consumers around the globe benefit from this new economy by being exposed to a greater amount of high-quality goods and services at low prices. It must be stated that, with such access to goods and services, there must necessarily be some downside. Americans can no longer expect that, as has been the case in previous decades, the former “firewall” of national boundaries will negate international pressures in the current global economy.

Once, the strength of America’s economy was centered in the capacity of its abundant natural resources and the sheer capability of its workforce. The nation continues to possess vast resources. The total of its workforce is the best-trained and best-equipped on the planet. Many countries continue to make inroads to compete with the US, especially in segments of service industries.

A newer, global economy provides substantial benefits to consumers and to workers around the world. Enhanced levels of quality in products and in services is expressed by the end-product of many interconnected players that no longer must be found in geographic proximity. The United States continues to be a leader in fostering innovation and in the creation of new technologies. The country’s businesspersons show a remarkable capacity to respond faster and smarter to the commercialization of these technologies. Protectionist policies of the past will only serve to diminish the benefits of participation in a modern environment and global economy in which American products are required. The increasing ease of transferring digital information around the world is matched by the subsequent dislocation of workers. Optimally, American workers should be displaced upwards, to high-levels positions in an ever-expanding theater of new processes and new forms of technology. America's preeminent resource today is its ability to innovate; the greatest possible problem for the US is the potential loss of such unsurpassed competency.

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