Stories opponents of outsourcing tell are too simplistic

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Reports that technology giant IBM now employs more people in India than in the U.S. (estimated at 130,000 vs. 100,000) will worry those concerned with globalized outsourcing.

Certainly, President Donald Trump might have something to say. Last November, he accused IBM of laying off 500 Minnesotans and moving their jobs overseas. With IBM CEO Ginni Rometty part of the Trump business advisory council, which publicly folded in the wake of the Charlottesville rallies, chances are the president will revive this critique.

Critics of outsourcing tell a simple story about companies like IBM closing or downscaling American factories and premises. American workers get laid off, they imply, and the company simply re-opens production in cheaper environments, with exactly the same services sold as before.

But is this what’s happening, and should it concern us?

Even if the outsourcing eliminates some domestic jobs as suggested, there are upsides too. Outsourcing can be a mechanism to produce the same product more cost effectively. This can help deliver cheaper products to American clients and businesses.

The long-term productivity gains associated with efficient outsourcing can have other spillover benefits too. Rising wealth in the developing world itself creates new demands for American products, particularly high-end complementary legal and financial services.

If the outsourcing improves profits margins, these can flow back to the U.S. as well.

Outsourcing of this form is really just a form of international trade. It harnesses specialization to lower costs of production and in turn enables domestic workers to shift toward higher productivity activities. Yes, there can be short-term disruption for those who lose jobs, but the labor market tends to be incredibly dynamic anyway.

Over the 12 months to the end of July, U.S. job hires totaled 63.6 million and separations 61.5 million. Compared to these figures, the flow of jobs outsourced is a drop in the ocean.

The reality though is that the stories opponents of outsourcing tell are too simplistic. As my colleague Dan Ikenson has written, less than 10 percent of U.S. investment abroad tends to be for the purpose of production for export back to the United States.

Over 90 percent of outward foreign direct investment is actually destined to serve foreign goods and services markets or for performing value-added activities in transnational supply chains. With a burgeoning middle-class worldwide, companies often need an extensive footprint in a foreign market to serve their customers effectively.

IBM itself provides an example here. Its Indian workforce does some of its core work in managing the computing needs of major companies such as AT&T and Shell (a more traditional form of outsourcing). But they are also a hub for business development for the developing world.

The company has been using its artificial intelligence technology to work with the Bangalore chain of Manipal Hospitals, for example, to treat certain cancers.

Expansion of foreign affiliates, then, is often not just about cost-saving, but reorienting activities to serve changing demands and markets. Foreign affiliates often complement, rather than substitute for, domestic activity.

Using evidence from the U.S. Bureau of Economic Analysis for 1998 to 2012, Dan Ikenson found a positive relationship between U.S. parent companies and foreign affiliate capital expenditure in 12 of 15 years and a positive correlation between employment changes in nine of those years.

All of which suggests investing abroad does not directly come at the expense of domestic production.

Rather than shaming companies like IBM for business decisions, the president should focus instead on domestic policies that deter investment within the United States. Taxes, damaging regulations and immigration policy can make otherwise competitive domestic production uncompetitive.

President Trump’s executive order discouraging H1-B temporary visas for lower-paid tech workers, for example, is likely to exacerbate the trend toward outsourced information technology work overseas. A radical domestic tax reform agenda could likewise improve the likelihood of businesses investing and opening facilities here.

Companies consider many things when choosing how to structure their business, including the domestic and international policy environment, wage costs, access to skills and infrastructure and the ability to reach consumers.

Politicians can improve the broader domestic business environment. But beyond that, just as with trade, attempting to cajole or prevent businesses from investing productively to reduce costs or reach new markets would leave us all worse off.

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