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# Daniel J. Ikenson: Outsourcing is good, without the politics

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In an era of misinformation overload, it is disheartening to see the Washington Post perpetuating the ignorance surrounding the issue of outsourcing. To be sure, in addressing the topic in Tuesday's paper, writers Tom Hamburger, Carol D. Leonnig, and Zachary A. Goldfarb were merely presenting the case of Obama's critics "primarily on the political left," who claim the president has failed to make good on his promises to curtail the "shipping of jobs overseas." That conclusion may be accurate. But the article's regurgitation of myths about outsourcing and trade, peddled by those who benefit from restricting it, gives readers a parochial perspective that leaves them confused and uninformed about the manifestations, causes, consequences, benefits, and costs of outsourcing.

Outsourcing is a politically charged term for U.S. direct investment abroad. Although the large majority of that investment goes to rich countries, the Post article claims that "American jobs have been shifting to low-wage countries for years, and the trend has continued during Obama's presidency." While that may be factually true, the numbers are likely fairly small. Many more jobs have been lost to the adoption of more productive manufacturing techniques and new technologies that require less labor. And we, overall, are much wealthier for it.

The article attributes 450,000 U.S. job losses to imports from China between 2008 and 2010 – a figure plucked from an "economic model" at the Economic Policy Institute that has been criticized by everyone in Washington but Chuck Schumer and Sherrod Brown. That estimate is the product of simplistic, inaccurate assumptions equating the value of exports and imports to set numbers of jobs created and destroyed, respectively, as if there were a linear relationship between the variables and as if imports didn't create any U.S. jobs in, say, port operations, logistics, warehousing, retailing, designing, engineering, manufacturing, lawyering, accounting, etc. But imports do support jobs up and down the supply chain. Yet, so blindly committed are EPI's stalwarts to the proposition that imports kill U.S. jobs that they even suggest that the number of job losses would have been greater than 450,000 had the U.S. economic slowdown not reduced demand for imports. In that tortured logic, the economic slowdown saved or created U.S. jobs. But I digress.

Contrary to the misconceptions so often reinforced in the media, outsourcing is not the product of U.S. businesses chasing low wages or weak environmental and labor standards abroad. Businesses are concerned about the entire cost of production, from product conception to consumption. Foreign wages and standards are but a few of the numerous considerations that factor into the ultimate investment and production decision. Those critical considerations include: the quality and skills of the work force; access to ports, rail, and other infrastructure; proximity of production location to the next phase in the supply chain or to the final market; time-to-market; the size of nearby markets; the overall economic environment in the host country or region; the political climate; the risk of asset expropriation; the regulatory environment; taxes; and the dependability of the rule of law, to name some.

The imperative of business is not to maximize national employment, but to maximize profits. Business is thus concerned with minimizing total costs, not wages, and that is why those several factors are all among the crucial determinants of investment and production decisions. Locales with low wages and lax standards tend to be expensive places to produce all but the most rudimentary goods because, typically, those environments are associated with low labor productivity and other economic, political, and structural impediments to operating smooth, cost-effective supply chains. Most of those crucial considerations favor investment in rich countries over poor.

Indeed, if low wages and lax standards were the real draw, then U.S. investment outflows wouldn't be so heavily concentrated in rich countries. According to statistics published by the Bureau of Economic Analysis, 75 percent of the $4.1 trillion stock of U.S. direct investment abroad at the end of 2011 was in Europe, Canada, Japan, Singapore, Australia, New Zealand, Taiwan, Korea, and Hong Kong (i.e., rich countries). In contrast, only 1.3 percent of total U.S. foreign direct investment stock is in China.

Likewise, if wages and lax standards were magnets for investment, we wouldn't see the vast sums of foreign direct investment in the United States that we do, and the United States wouldn't be the world's most prolific manufacturing nation. At the end of 2010, foreign direct investment in the United States totaled over $2.3 trillion, one third of which was invested in U.S. manufacturing facilities. As the president and his critics (including candidate Romney) drone on about the ravages of "shipping jobs overseas," they should take a moment to note that 5.3 million Americans work for U.S. subsidiaries of foreign companies (jobs "outsourced" from other countries). And they should note that Europe's Airbus announced last week that it is making a $600 million investment in a 1,000-worker aircraft assembly plant in Mobile, Alabama, just down the road from the $5 billion, 1,800-worker steel production facility belonging to Germany's Thyssen-Krupp, which is located within a few hours' drive of a dozen mostly foreign nameplate auto producers, who employ tens of thousands more U.S. workers and generate economic activity supporting thousands more. These investments, jobs, and related activity are the products of foreign companies outsourcing.

Why do these foreign companies come to American shores to produce instead of producing at home and exporting? Because each company has determined that it makes sense from an aggregate comparative cost perspective. They're not here because of low wages or lax enforcement of labor and environmental standards, but because all of the factors affecting cost that each company uniquely considers, weigh – in the aggregate – in favor of investing here. One very important factor for a growing number of companies is proximity to market. Shipping products long distances can be costly, particularly for time-sensitive products and parts. And having a productive presence in your largest or fastest growing market is a factor that carries significant weight. Exporting is not always the best way to serve foreign demand.

But outsourcing has been stigmatized as a process whereby U.S. factories are disassembled rafter-by-rafter, machine-by-machine, bolt-by-bolt and then reassembled in some foreign location for the purpose of producing goods for sale back in the United States. There may be a few instances where that accurately depicts what took place, but it is simply inaccurate to generalize from those cases. According to the BEA research described in these two papers (Griswold and Slaughter), between 90 and 93 percent of U.S. outsourcing – investment abroad – is for the purpose of serving foreign demand. Only between 7 and 10 percent of that investment is for the purpose of making sales back to the United States.

In 2009, U.S. multinationals sold over $6 trillion worth of goods and services in the foreign countries in which they operate, which was nearly quadruple the value of all U.S. exports that year. Outsourcing helps make U.S. multinational corporations more competitive, and the profits they earn abroad (even if they're not repatriated) underwrite investment and hiring by the parent companies in the United States. Typically, the U.S. companies that are investing abroad are the same companies that are investing in the United States for reasons that include the fact that U.S. MNC investment abroad tends to spur complementary investment and hiring in the U.S. parent operations.

The capacity to outsource also serves another crucial, underappreciated function: to safeguard against bad U.S. policy. Like tax competition, outsourcing provides alternatives for businesses, which help discipline sub-optimal or punitive government policy. Because of globalization and outsourcing, businesses can choose to produce and operate in other countries, where the economic and political environments may be more favorable. As more and more companies undertake these comparative aggregate cost-of-doing-business assessments, governments will have to think long and hard about their policies.

Governments are now competing with each other to attract the financial, physical, and human capital necessary to nourish high value-added, innovation-driven, 21st century economies. Restricting or taxing outsourcing as a means of trapping that investment wouldn't be prudent. It would render U.S.businesses less competitive, and ultimately reduce employment, compensation, and economic activity. In this globalized economy, policymakers cannot compel investment, production, and hiring through threat or mandate without killing the golden goose. But they can incentive U.S.companies to return some operations stateside and foreign firms to invest more here by adopting and maintaining favorable policies.

According to the results of a survey of over 13,000 business executives worldwide published in the World Economic Forum's Global Competitiveness Report 2011/12, there are 57 countries with less burdensome regulations than the United States. That same survey found that business executives are increasingly concerned about crony capitalism in the United States, ranking the U.S. 50th out of 142 economies in terms of the government's ability to keep an arms-length relationship with the private sector. Then consider the fact that the United States has the highest corporate tax rate among all OECD countries. Add to that the prevalence of frivolous lawsuits, political uncertainty, out-of-control government spending, the dearth of skilled workers, uncertainty about the tax burden come 2013, and it starts to become clear why U.S. companies might consider investing and producing abroad. But policymakers can improve policy — in theory, at least.

It boils down to this. About 95 percent of the world's consumers and workers live outside the United States. We live in a world where U.S. companies have much more competition on the supply side, much greater opportunity on the demand side, and far greater potential for tapping into a global division of labor (i.e., collaborating across borders in production) than 50, 20, even 5 years ago. After a very long slumber, the rest of the world has come on-line. We should embrace, not curse, that development.

In a globalized economy, outsourcing is a natural consequence of competition. And policy competition is the natural consequence of outsourcing. Let's encourage this process.