Offshoring jobs might not threaten the national welfare to the degree publicly perceived, says economist

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(Phys.org) -- Sending jobs overseas may not be as damaging to the U.S. economy as commonly believed, according to a study by a University at Buffalo economist.

Offshoring, the practice of moving specific operational tasks originally performed in one country to a new location abroad, is just another form of trade in goods and services, says UB economics professor Winston Chang, an expert in international economics. U.S. firms, in fact, become more efficient and competitive when offshoring savings are redirected to new areas of operation, new products and services, or invested in further research and development, Chang noted.

Chang's paper, which appears online in the Social Science Research Network (SSRN) paper #2016984, collects research from numerous studies supporting a conclusion long held by economists but not similarly embraced by the general public: that services offshoring has had a negligible impact on net employment and median earnings in the U.S.

Although offshoring is blamed for a staggering quantity of job losses and has created heated debate in the media, Chang cites research that indicates the projected number of 3.4 million jobs offshored between 2002 and 2015 in nine occupational categories prone to offshoring is a miniscule 0.53 percent of the nearly 60 million jobs within those categories.

"The potential job loss, though different among industries, is not as large as feared," said Chang. An annual loss of 100,000 service jobs is about 0.1 percent of total employment, according to studies. The possibility of that trend continuing, however, raises fears that most or all service jobs, which account for 70 percent of U.S. employment, could be eventually offshored. Chang says those concerns are both empirically and theoretically flawed.

"Services such as catering, retail, hotels, restaurants, tourism and personal care, which require the buyer and seller to be present in the same place, cannot be outsourced," said Chang, referring to the argument's empirical mistake. "Furthermore, offshoring occurs mostly to mundane and standardized types of work. Complex jobs that require higher skills are more difficult to offshore. High-skilled workers benefit from the vast increase of low-skilled workers in the world. Offshoring promotes growth in developing countries, raising income and creating more demand for high-skill products."

In addition, Chang noted that "a lot of transactions are not suited to the arms' length approach. Instead, they require the establishment of long and familiar business relations." The world is not flat in this respect, he said.

By offshoring some stage(s) of production abroad, U.S. firms can create more domestic employment in other stages of production, Chang said. "The upstream blueprint designs and the vast downstream distribution and retail operations in the U.S. benefit from the possibility of offshoring some intermediate stages of such production as manufacturing and assembly operations."

Cost-saving offshoring is the result of a foreign country's ability to produce a good or provide a service at a lower cost than a domestic firm, Chang said. But that level of foreign production superiority, although initially present, does not remain constant. It changes over time. Offshoring, Chang said, tends to narrow the wage gap of the same skill level between the advanced and developing countries. Consequently, offshoring's appeal diminishes as the gap continues to contract.

"Offshoring has undoubtedly contributed to the economic growth of many developing countries, which has led to currency appreciation and higher standards of living," he said. "It is possible that we are about to see the tides turn as manufacturing activities are being 'reshored' back to the U.S. due to rising costs in these developing countries."

GE is one of the firms to have pulled jobs back to the U.S. Sharp wage increases in India's IT sector, along with the U.S. recession and the decline of the U.S. dollar, in fact, led the company to dispose of back office operations that had been offshored to India, Chang said.

One important point in the offshoring debate arises from suggestions of limiting or prohibiting the practice. Chang said U.S. companies would be placed at a strategic disadvantage in this competitive world.

"One scenario envisions the eventual shut down of the U.S. firms due to its high costs or their migration to foreign countries to become foreign firms. The U.S. then may have more layoffs as a result of losing U.S. firms," said Chang. "To survive in the competitive international market, `strategic offshoring' is an important determinant in a firm's offshoring decision."

The statistics and percentages, however, do little to ease the hardships of displaced workers and their families. Yet Chang says a review of the research literature reveals that about two-thirds of displaced workers are reemployed within two years.

One study showed about half of those reemployed ended up with jobs that paid roughly as much or more than their previous positions, while the other half experienced wage cuts of 15 percent or more. Another study found that more than 75 percent of service workers who lost their jobs due to offshoring found new jobs within six months. The median wage of those reemployed, however, was 11 percemt below their previous wage.

Chang said despite those figures, displaced workers remain the most pressing concern about offshoring. Aside from unemployment insurance, there are programs currently in place to address the issue, including Trade Adjustment Assistance (TAA) which offers an additional 52 weeks of income support once displaced workers have exhausted their unemployment benefits. Other proposals on how to address and lessen offshoring's impact on social welfare include a wage insurance program that pays a 30 to 70 percent income subsidy to all involuntarily displaced full-time workers for lost wages over a two-year period. It is believed the cost, estimated as high a $7 billion, would speed reemployment.

A private wage insurance program has also been suggested, Chang noted. It would require businesses to purchase insurance for displaced workers to cover lost wages during the median period of unemployment. Other proposals include granting R&D tax credits and removing foreign trade barriers against American exports.

Provided by University at Buffalo