Outsourcing, Offshoring, and Job Security

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There's been a lot written lately about the phenomena of outsourcing and offshoring. They are sometimes portrayed as the latest economic bogeymen that threaten job security and the well-being of individuals in our economy. Can we restore the job security and ensure the welfare of U.S. workers by somehow limiting outsourcing and offshoring? In other words, should the government "do something?" The answer to both is no. It would only lead to a false sense of security and ultimately to worse economic outcomes.

Outsourcing, put simply, is the "make-or-buy" decision, e.g., does the firm make its own components, provide its own janitorial services, have its own food service, etc., or does it hire an outside firm to do these things? Presumably, when making this decision a firm considers the cost, quality, responsiveness, and reliability of outside suppliers relative to in-house supply and chooses the most efficient supply arrangement. Offshoring is related to outsourcing, but here the firm's decision is whether to have a good or service produced overseas or in the U.S. The offshore production may be in house, as with a foreign branch of the firm, or with an outside foreign firm. In either case, firms presumably make a similar decision regarding whether overall efficiency is higher by production in the U.S. versus overseas.

All seems pretty sensible. After all, who would advocate encouraging firms to choose less efficient or higher cost supply arrangements?! However, some claim that jobs are lost when firms outsource or offshore in search of lower costs. As it turns out, this is not completely correct. Jobs are moved around. They are lost in one place but picked up elsewhere. This is easiest to see with outsourcing. If an assembler of a manufactured product previously produced its own components and then begins to outsource their production, its own employment falls but that of its suppliers rises. Jobs move from the original firm the supplier firm.

A similar phenomenon happens with offshoring, though it's not as straightforward to see. Offshoring essentially means that a good or service is being imported. However, for every import, there is an equal and opposite export. Overseas suppliers want something in return for whatever they ship here. This implies goods being produced here for export. Thus, jobs decline in the U.S. in producing the good or service now imported, but increase for the production of exports. Again, the jobs move around.

Jobs "moving around" in the U.S. economy is a pretty normal thing. For example, the U.S. Bureau of Labor Statistics recently reported that in the second quarter of 2006, there were 7.8 million private-sector jobs created and 7.3 million lost. (See http://www.bls.gov/news.release/pdf/cewbd.pdf.) Thus, in the normal course of events there is a lot of job creation and destruction, part of which is due to outsourcing and offshoring. Nevertheless, the total number of jobs increases. Firms that successfully supply goods and services desired by the marketplace flourish and grow and firms that do not decline. This is how firms in market economies end up providing the goods people value and, as a result, generating high standards of living for their citizens.

Thus, at one level, outsourcing and offshoring are part of the normal reallocation of jobs in a well-functioning economy. At another level, however, it's not so "normal" . . . if you're one of those with a job that was outsourced or offshored! For these people, their job security and economic welfare are threatened. Because outsourcing and offshoring create jobs elsewhere, new jobs are out there for the displaced workers. But where are they and do they match the skills of those who lost their jobs? Those displaced must find the newly created jobs and perhaps acquire new skills. This may entail some hardship while this occurs.

This is a problem, but what to do about it? To answer, it's helpful to remember what brings us a high standard of living. Fundamentally, it is high productivity in providing valuable goods and services because, in the end, we consume the goods and services that we produce or trade for. Maintaining a high standard of living entails maintaining a high level of productivity. Part of this is having firms seek the most efficient way to get their products produced, whether via outsourcing, offshoring, or other means.

Thus, it an effort to shelter workers from hardship when jobs move around, it is important not to interfere with firms' seeking efficient production. Many European countries have taken the wrong path on this by adopting strong "job protection" laws, making it is very difficult and costly for firms to layoff workers for any reason. As a result, companies are left with an excess number of workers when a product's demand turns down and others are reluctant to hire additional employees for fear that they never can be laid off if things don't work out. Economy wide, this translates into low productivity and high unemployment. There are a lucky few who have secure jobs, but at the expense of lower standards of living and insecure employment for the many.

A better alternative is to provide a safety net for those who lose their job such that they can sustain a temporary period of job search and/or retraining. This would keep in place the incentive that firms have to be efficient and productive . . . which may entail use of outsourcing and offshoring. We can't wave a legislative magic wand of job protection and suddenly be better off. Doing so only gives false sense of security ultimately leads to lower economic welfare.

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