The non-threat that is outsourcing.

By Raghuram G Rajan And Shang-jin Wei.

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Jobs lost by outsourcing are offset by jobs created by insourcing and by purchases of industrial countries' goods

EVERY decade or so, developed countries develop a crisis of confidence: if jobs keep migrating overseas will there be any jobs left at home? For example, in the United States in the 1980s, it was fear of Japan.

In the 1990s, it was 'the giant sucking sound' from Mexico. Today, India and China are regarded as threats, and outsourcing of jobs is blamed for jobless growth in the developed world. Of course, the rhetoric usually heats up when elections are near.

In a sample of US newspapers and magazines, there are local peaks in the number of articles on outsourcing in 1996, 2000, and 2004, all election years. Similarly, slow domestic job growth raises interest in outsourcing - in the first two weeks of March, when jobless recovery was on everyone's mind, there were three times as many articles on outsourcing and unemployment as in the last two weeks of April after reports of strong US job growth.

So will the current anxiety over outsourcing, echoes of which we hear from Australia to the United States, die down once we move beyond elections and once the recovery becomes firmly established?

This episode is different from past periods of anxiety over imports, which is why one cannot be sanguine that it will pass as easily. Outsourcing of services is different in one important way from imports of physical goods - it is harder to control, therefore less predictable and a greater source of anxiety.

The service sector was largely impervious to international competition in the past. Accountants did not fear someone overseas would take their high-paying jobs, but they certainly benefited from the cheap imported manufactured goods that open trade allowed. For this reason, service sector professionals were staunch supporters of open trade.

Now, services can cross political borders via the airwaves. Jobs in fields ranging from architecture to radiology seem much more at risk. While it was possible for firms to relocate abroad in the past, they had to give up something - their closeness to important markets, for example.

With the new technologies they can retain these links while also obtaining access to cheap, but well-trained labour. The difficulty of controlling the spread of outsourcing, and the worry it could expand dramatically, contribute to the fears of white collar workers.

No wonder a study conducted by the University of Maryland found that among those with incomes over US$100,000, the percentage actively supporting free trade slid from 57 per cent in 1999 to 28 per cent in January 2004. If the service sector in developed countries weakens in its support, the political balance could turn irretrievably against free trade.

The truth, however, is that service workers in the developed world would, by and large, be made worse off by a universal ban on outsourcing. While traditional arguments for free trade - such as that it lowers costs and preserves competitiveness - also hold for outsourcing, which is a form of trade, new findings by Mary Amiti and Shang-Jin Wei of the IMF Research Department suggest reasons to support it.

First, consider the amount of 'insourcing', that is, the value of business services exported by a country like the US. Clearly, this is considerable - think of all the high-priced business consultants and lawyers in rich countries offering their services to the rest of the world.

What is noteworthy, however, is that in each of the past 10 years, the value of US insourcing has been greater than that of US outsourcing! This is true even though the US has been running a trade deficit and an overall current account deficit.

Most other rich economies also run a surplus in these service categories. None of this should be surprising as the rich countries tend to do high-value-added service activities relatively better than the rest of the world. In fact, the US has the largest dollar surplus of insourcing over outsourcing in computer, information, and business services (at US$21 billion in 2001). The second-largest surplus country, by the way, is not India, but the UK.

Put another way, if every country decided to put up barriers against outsourcing, the output of developed countries would fall far more than that of developing countries.

Has outsourcing caused a decline in job growth in advanced economies? This question can be answered at two levels: economy-wide and individual sectors. For the whole economy, the answer is a clear no. The jobs lost because of outsourcing are offset by jobs created by insourcing and by the large purchases of industrial countries' goods by developing countries.

This is why unemployment in the developed world has not increased significantly over the last decade.

What about the effect at the sector level? Here, the answer is ambiguous. On the one hand, every job outsourced is a job lost. On the other hand, companies that outsource will likely become more productive and expand employment in other ways.

To resolve the ambiguity, IMF researchers used US government data to divide the US economy into over 100 sectors. They computed the intensity of outsourcing sector by sector, ranked them by this intensity, and examined whether the rank had any relationship with relative job growth across these sectors.

The bottom line: there is no evidence that the most outsourcing-intensive sectors have had systematically slower (or negative) job growth in the last decade. In fact, the millwork and plywood sector, the metal coating, engraving, and allied services sector, and the insurance industry have had some of the fastest increases in service outsourcing but at the same time also some of the fastest rates of job creation.

All this does not suggest that people's anxieties should be ignored. In fact, assistance to displaced workers - including training and retraining - can be improved. The benefits of outsourcing can also be spread more evenly.

Nevertheless, IMF research suggests that service outsourcing has not hurt developed countries. Workers in rich economies are best served if their governments choose to embrace outsourcing and deal directly with its consequences rather than suppress it.

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