



Should we be protected against foreign outsourcing?

With markets moving toward increasing globalization, the prospect of seeing companies transfer part of their activities abroad is causing growing alarm. In Canada, firms in leading-edge industries such as CGI and Nortel announced successively over the past year that they plan to mandate certain tasks to suppliers in India. These tasks range from simple data entry to more complex financial analysis. In the United States, hardly a week goes by without outsourcing-related job losses or factory closings making the headlines. The “Exporting America” capsule presented each day on the *Lou Dobbs Tonight* program on CNN television illustrates as clearly as anything the magnitude that this phenomenon has acquired in the last year.

Many are worried in particular about the rising economic influence of some Asian countries such as China and India that can call upon an ample supply of increasingly qualified workers who are willing to work for a fraction of the salaries paid in industrialized countries. Pessimists predict a dark future for labour markets in developed countries if nothing is done to halt job transfers to emerging countries. The temptation may thus be great for Canada to follow the example of the United States, which has already taken protectionist measures to counteract the outsourcing movement.

Foreign outsourcing as a source of economic progress

A number of developments have led to substantial increases in worldwide exchanges of goods and services in recent decades. These include international agreements to liberalize trade and capital flows, technological progress in transportation and logistics, and electronic information exchange. The outsourcing phenomenon is part of this basic trend and is not fundamentally



new. It stems from the logic of business strategies aimed at lowering production costs in a context of worldwide competition.

A decision to outsource abroad comes down to the basic economic principle of specialization of tasks. Since companies cannot excel in every phase of production, the assignment of certain duties to specialized suppliers helps them reduce operating costs. In raising the quantity of goods and services produced per worker, these productivity gains generate economic growth. Producing more with a smaller quantity of resources helps companies

increase their earnings and provide the capital needed to finance new investments.

With access to a broader choice of higher-quality products at lower prices, consumers benefit from the outsourcing phenomenon and the resulting economic dynamism. Moreover, the productivity gains generated in this way spread to other sectors of the economy, with firms profiting from lower prices for the goods and services that enter their production processes.



For example, cell phones and personal computers are among the goods whose components were produced abroad at lower cost in the 1990s. According to an American study, globalization of production has made IT hardware up to 30 percent less expensive, enabling technology to spread and new jobs to be created in areas that depend on it.¹

Recurring fears of job disappearance

Obviously, stating that foreign outsourcing of services makes production more efficient or helps improve allocation of resources is not entirely reassuring to the workers affected. After all, if production becomes ever more efficient, should we not expect to see ever fewer job opportunities? And does handing foreigners work that Canadians could perform not run counter to the national interest?

The idea that foreign outsourcing contributes to job reductions relies on a static vision of the labour market and assumes that the quantity of work in an economy is fixed. This belief ignores the fact that an expanding economy is continuously producing new outlets not only in terms of products but also in terms of jobs. In a dynamic economy, even if greater openness to trade results in certain companies or industries going into decline if they cannot remain competitive, the number of jobs available over time tends to increase with productivity and the economic growth it generates. Outsourcing specific production activities abroad is thus likely to stimulate job creation even more. It can also help preserve jobs simply by enabling companies to remain competitive.

For example, in the 1990s, when Mexico joined the North American Free Trade Agreement (NAFTA), alarmists predicted a massive exodus of Canadian firms to this low-labour-cost country and the subsequent loss of many jobs.² The catastrophe never occurred. Labour costs are merely one factor among many that influence a company's decision to move its activities to another country. Low wages simply reflect the low productivity of Mexican workers.

Opponents of free trade failed to take account of stimuli to innovation that a greater opening of national markets would create. National firms have reacted to increased competition by seeking ways of standing out and by developing new niches in sectors with higher added value. The level of Canada's bilateral merchandise trade with the United States and Mexico nearly doubled between 1994 and 2004. It now stands at nearly \$600 billion a year.³ And workers have done well by it. According to Statistics Canada, in 2003 there were 105,000 more manufacturing jobs in Quebec – and 474,000 more across Canada – than there had been when NAFTA came into force ten years earlier. These jobs have moved upscale: they require greater qualifications and pay better. For example, manufacturing jobs paying \$25 an hour or more (taking account of inflation) went from 13.9% of the total in 1997 to 18.2% in 2004.⁴

Over this same period, the number of jobs in Canada, in all industries, rose by more than 2.6 million, with nearly 550,000 of these in Quebec.⁵ As Figure 1 shows, the number of jobs rose more quickly than the labour force and unemployment declined sharply as a result.

In addition, the relatively weak impact of foreign outsourcing on employment and labour is often exaggerated. Technological progress, for instance, has had a far greater impact. These phenomena are both caused by competition, which constantly forces companies to look for new ways of reducing costs and serving their customers better. In both cases, the result is the same: a short-term displacement of labour but with higher productivity and personal living standards in the long run.

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of specialization of tasks.*

1. Catherine L. Mann, "Globalization of IT Services and White Collar Jobs: The Next Wave of Productivity Growth," International Economics Policy Briefs, No. PB03-11, Institute for International Economics, Washington, December 2003, available at <http://www.iie.com/publications/pb/pb03-11.pdf>.
2. Presse Canadienne, "ALENA : 371 000 emplois pourraient être transférés au Mexique, selon le CTC," *La Presse*, July 28, 1993, p. E8.
3. Department of Foreign Affairs and International Trade/EET, State of Trade 2005, Statistical Appendix, Table 1E, available at http://www.dfait-maeci.gc.ca/eet/pdf/Biling_tables-State_of_Trade-2005.pdf.
4. René Morissette and Anick Johnson, "Are Good Jobs Disappearing in Canada?," Statistics Canada research paper, No. 11F0019MIE, Catalogue No. 239, available at <http://www.statcan.ca/english/research/11F0019MIE/11F0019MIE2005239.pdf>.
5. Statistics Canada, CANSIM Table 282-0008.



Figure 1

Change in the labour force, employment and unemployment since NAFTA (1994-2003)



SOURCE: Statistics Canada, CANSIM Table 282-0008.

The case of the farm sector over the last century provides a typical example. In 1901, this sector employed more than 40% of the entire Canadian labour force.⁶ Today, thanks to the progress of technology and to competition, just over 2% of the Canadian population is employed in agriculture. The manpower and resources that formerly went into this sector are used now in a multitude of other activities that improve our lives. Jobs lost in agriculture have been more than offset by jobs created in new areas of the Canadian economy. Often this involves professions or trades that did not exist only a few years back.

The costs of protectionism

The mistaken belief that the quantity of work in an economy is always constant lies behind the creation of many protectionist measures in numerous countries. For example, faced with the rise of the foreign outsourcing phenomenon in the United States, the reaction of some states was to penalize firms that engage in this practice. Since April 2003, some 35 U.S. states have introduced 150 legislative measures in this regard.⁷ The U.S.

Senate made a similar move by adopting a bill forbidding American companies from dealing with foreign subcontractors when working on contracts financed by the federal government.

These restrictions risk producing harmful consequences on American companies and, by extension, on American workers and consumers, especially if their competitors elsewhere in the world are free to deal with foreign subcontractors. Penalizing companies that outsource part of their activities abroad amounts to deterring them from lowering their production costs and innovating. Jobs are saved in the short term but at the cost of better-paying jobs that would have been created in leading-edge sectors.

Unfortunately, people often tend to forget that jobs maintained by this sort of protectionist measure carry a high price tag. A study by the National Foundation for American Policy reveals an interesting case.⁸ Following criticisms from residents of Indiana, the state governor cancelled a US\$15.2 million contract he had just issued to an Indian-based multinational company to set up a computer system for processing unemployment insurance claims. By reversing his decision and giving the contract to an American firm for US\$23.3 million, the governor may have “saved” 50 jobs in the United States, but at a cost to taxpayers of an extra US\$162,000 per job!⁹

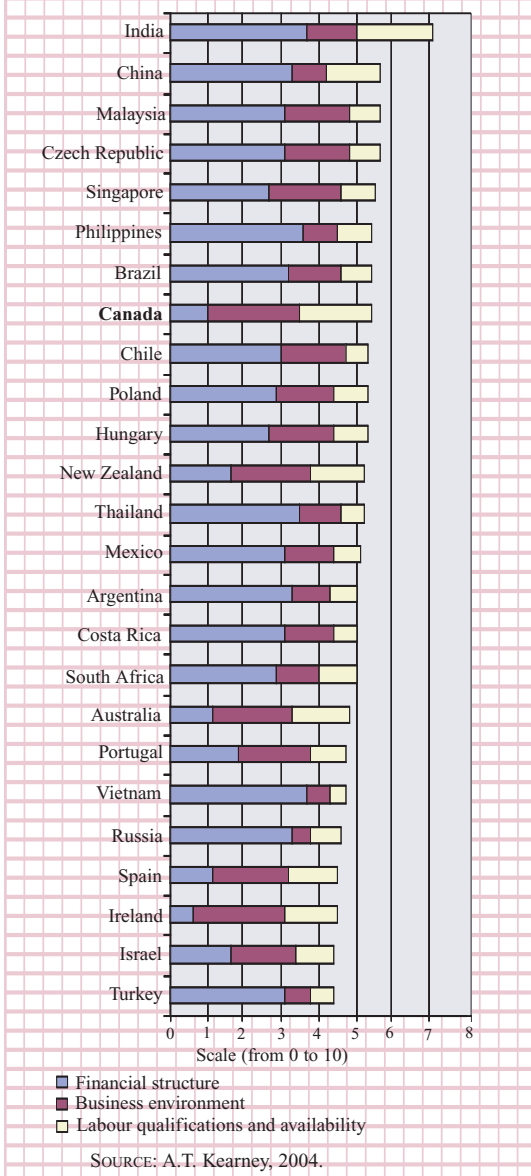
The relatively weak impact of foreign outsourcing on employment and labour is often exaggerated. Technological progress, for instance, has had a far greater impact.

6. Statistics Canada, *Historical Statistics of Canada*, Section D: The Labour Force, 1999, available at <http://www.statcan.ca/english/freepub/11-516-XIE/sectiond/sectiond.htm>.
 7. See National Foundation for American Policy, Table Tracking State and Federal Global Sourcing Legislation, available at <http://www.nfap.net/researchactivities/globalsourcing/appendix.aspx>.
 8. Stuart Anderson, “Creeping Protectionism: An Analysis of State and Federal Global Sourcing Legislation,” The National Foundation for American Policy, December 2003.
 9. The bid by Tata America International was \$8.1 million lower than the second lowest bid, submitted by Accenture and Deloitte Consulting, two U.S. companies. See Kevin Corcoran, “State Ends Deal with Indian Firm,” *Indianapolis Star*, November 21, 2003.



Figure 2

The most attractive countries for outsourcing



Protectionist legislation adopted by the United States risks having negative repercussions on Canada's economy, which remains intimately linked to that of its neighbour. Such legislation may be all the more harmful in that Canada is among the world's most highly regarded places for outsourcing, by American companies in particular. According to a report by the United Nations Conference on Trade and Development (UNCTAD), Canada was among the top four beneficiaries in 2001 of outsourcing of services, along with India, Ireland and Israel. These four countries together accounted for 71% of the market for "offshored" services.¹⁰ In 2004, the Offshore Location Attractiveness Index, measured by the American firm A.T. Kearney,¹¹ rated Canada among the best destinations in the world for outsourcing, with top ranking among the industrialized countries (see Figure 2).

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It should be recognized that foreign outsourcing of activities causes short-term pain for workers who lose their jobs. This makes it all the more necessary that our labour force be better trained so that workers can move up to jobs with higher added value

and be ready to deal with new labour market realities. Seeking to slow the outsourcing phenomenon is not a solution. Canada has not adopted protectionist laws up to now and should continue along its path of openness. As the Canadian Minister of International Trade has correctly noted: "We cannot halt labour market evolution through protectionism without paying a heavy price now and in the future ... Protectionism protects no one, least of all those it is invoked to protect. It is a misguided doctrine rooted in the belief that we can make time stand still."¹²

10. United Nations Conference on Trade and Development (UNCTAD), "The Offshoring of Corporate Service Functions: The Next Global Shift?" in *World Investment Report 2004: The Shift Towards Services*, United Nations: New York and Geneva, 2004.
 11. A.T. Kearney, "Making Offshore Decisions: Offshore Location Attractiveness Index," 2004, available at http://www.atkearney.com/shared_res/pdf/Making_Offshore_S.pdf.
 12. Jim Peterson, Speech to the World Trade Centre Montreal, March 10, 2004.


Montreal Economic Institute

Montreal Economic Institute
 6708 Saint-Hubert Street
 Montreal, Quebec
 Canada H2S 2M6
 Telephone: (514) 273-0969
 Fax: (514) 273-0967
 e-mail: info@iedm.org
 Web site: www.iedm.org

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