# IMPACT OF GOVERNMENT RESTRICTIONS ON OUTSOURCING, HIDDEN COSTS OF OUTSOURCING AND OUTSOURCING'S EFFECT ON UNEMPLOYMENT

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## Abstract

*In the developed countries outsourcing is often considered by the people as bad because it allegedly takes away their jobs and increases competition. But economists, financial analysts and experts view outsourcing as the international trade which benefits the companies outsourcing the activities and the helps growth of the country from where the outsourcing is happening in the long-run. While analysing the claims of the experts and the conception of the general public it was found that big companies of the U.S. like Walmart, Apple are earning huge profits by outsourcing their activities to other countries. Any restrictions put by the U.S. government in their outsourcing activities could make them less competitive in the international market. In addition to this, it was also concluded that companies often overlook the hidden costs of outsourcing while making their outsourcing decisions and these hidden costs should be carefully calculated so as to come to the actual estimate of the profits which companies make by outsourcing their activities. Apparently, it seems that due to outsourcing jobs are going away from one country to another but if looked in absolute terms they are not going away, on the contrary, outsourcing is helping the businesses to expand, profits to increase and accumulation of capital which is eventually creating more employment opportunities in the country from where activities are getting outsourced.*

**Keywords:** *Outsourcing, Government Restrictions, Hidden Costs, Unemployment, the United States*.

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## Introduction:

Economists consider outsourcing as merely a form of international trade, more specifically it is considered as the importing side of international trade. And in an economist's view, trade is always good for the markets and economies, and restricting trade can hinder economic growth.

But public view outsourcing as something which increases competition and takes away their jobs.
In the public's mind, the issue of trade is inextricably linked to the issue of job creation. According to the public's worldview exports are good, because they create jobs, and imports are bad because they allow foreigners to steal their jobs. And because outsourcing is the importing side of the international trade, they view it as a form of competition.

So, economists look at the economic growth side of outsourcing and public look at its unemployment side, and it is being said, that this the debate between economic welfare and social welfare.

But, we have to find out the answer to the question that "when politicians say they will restrict outsourcing, are they not promising to make their countries poorer"? So welfare of the state is not the concern in this paper. We will stick on three words outsourcing, economic growth and economic downfall.

So, in the third part of the paper, we will show that, how this problem of unemployment is not just related to society's welfare, how it can create downfall in the economy, as well. Will also try to find out that, whether outsourcing really causing unemployment, by putting forward, arguments, counter-arguments and empirical findings.

In the first part, we will keep some facts regarding the outsourcing activities of two top U.S.
Companies Apple and Walmart, using those facts, some arguments and examples, I will try to find out, the possible effects of putting restrictions on outsourcing.

In the second part, we will discuss some issues related to outsourcing, on whom, if due attention will not be given, then outsourcing can backfire and instead of increasing economic growth, outsourcing can hinder economic growth.

By keeping in mind the findings of the three parts, in the fourth part, we will answer the question "when politicians say that they will restrict outsourcing, are they not promising to make their countries poorer".
And the conclusion part will show the key findings.

## I. Possible effects of putting restrictions on outsourcing:

At a time, when the American government is having a hard time, in pushing the unemployment figures down, people are cursing outsourcing, as the main reason behind their unemployment.

According to a survey 'more than 70 percent Americans believe that outsourcing harms the US economy'.
Almost two-thirds of Americans consistently oppose outsourcing and fewer than two percent two percent consistently support it. Due to this public anger against outsourcing, politicians talk about making policies, to restrict outsourcing. Some examples of how politicians are enacting policies to restrict outsourcing. In the U.S., in August 2010, to prevent skilled workers from other countries from coming to the United States, Congress voted to increase L1 and H1-B visa fees. In that very month, for offshore services, the use of public funds was banned in the state of Ohio.

Now, that politicians have started implementing policies to restrict outsourcing, the debate on the effects of these policies is heating up. Before putting different arguments of this debate, we would first like to put forward some facts related to USA's two such companies, which are playing a great role in boosting America's economy. They are Apple and Walmart.

70 percent of all the Apple gadgets people use are made in foreign countries like China. Low wages, quick turnover, fewer regulations, industrial 'work where-you-live' dormitory/factories, no or low taxes and bonanza profits all combine to offer an enticing appeal for not only Apple but many other manufacturers to ship job overseas. The workers practically live on the assembly line where they churn out the products, so they would be awakened during the night, given a biscuit and a cup of tea, then ordered to work on 12-hour shifts to fix a glitch in iPhones. On the profits of Apple, Apple has announced record profits this quarter, which is going to help the U.S. GDP to rise.

According to Walter Isaacson's biography of Steve Jobs Obama was told by the late Apple founder that to support its vast manufacturing operations there weren't enough engineers in the U.S. Steve also said that due to government regulations it has become difficult to set up factories in the U.S.

Some facts on the giant retailer Walmart are Walmart who keeps the U.S. consumers happy with cheap clothes and wares, have fought to stagnate wages of workers in their outsourced Bangladesh factories under 2 cents per jeans back in 2010, for they didn't want to pay the 35 cents more the government was asking for. The irony is, if they would be producing these jeans in their own country, then they would have to pay, at least, 20-30 times more than 35 cents, to the workers.

The above-stated facts, suggests a few things. Low cost, fewer regulations and quick turnover are some factors which are attracting companies towards outsourcing. Outsourcing is making companies, more competitive by curtailing their costs, increasing their production, and increasing their profits. Companies' higher profits are helping their countries GDP to grow, and in making their country richer.

Politicians' policies of restricting outsourcing can reverse this situation. They can result in making their companies less competitive, by increasing their cost and decreasing their efficiency, which can lead to a fall in their profits or can even result in their winding up. Effect of all this on their country's economy is quite obvious, GDP will fall, and the country will become poorer.

David Poole, Vice President and head of Americas Business Process Outsourcing, was asked in an interview, on outsourcing restrictive policies. David Poole said anything that actually reduces a company's ability to manage their costs and compete on an international basis will have a negative impact. A company that is less competitive won't be able to grow and is less likely to succeed in the global economy. He further said, stopping companies from using lower cost resources force them to increase their prices and I'm not sure that's positive for the economy.

Steel tariff issue should be looked at before penalizing companies that outsource offshore. To save the steel-producing industry the government was lobbied by the steel companies to enact duties on foreign steel. From steel-producing states, the politicians and the squeaky wheel prevailed. For the metal fabricating industry resulting tariffs were disastrous and bankruptcy was continued to be filed by the steel companies even with the high tariffs. For its booming operations China consumes vast amounts of steel and as a result, there is steel shortage. Producers which are U.S. based have raised prices. The increased tariffs might have benefitted some steel producing companies but the overall effect doesn't appear to be beneficial to the overall manufacturing industry.

We saw that outsourcing is generating anger amongst public and politicians are talking about making policies to restrict outsourcing. The examples of Apple and Walmart showed us that how companies are outsourcing their activities, cutting their costs, earning huge profits, contributing to their country's GDP and making their country richer. The example of steel industry showed us that how policies which restrict outsourcing, can affect an industry in a harmful manner, argument of David Poole, showed, how these policies, can make internationally trading companies less competitive and less profitable, how these policies can harm the economy, causing GDP to fall and making a country poorer.

## II. Issues which should be kept in mind while outsourcing:

Companies involved in outsourcing activities and governments of those companies' countries should make sure that any unnecessary outsourcing should not happen, because it could lead to an increase in the unnecessary trade deficit, resulting in a fall in GDP and increase in unemployment.

Inappropriate outsourcing is the real problem and not outsourcing, inappropriate outsourcing can be described as purchasing products from other countries the products that could have been made more cost-effectively at home. That happens when: unnecessary barriers were thrown by U.S. policy to domestic production; businesses unfairly subsidized by the foreign government or simply competitive American products are kept out, or U.S. firms towards foreign sourcing have an inappropriate bias.
This can lead to a swell in the trade deficit, and research shows that unnecessary outsourcing is responsible for at least half the $600 billion U.S. trade deficit and eliminating half of this trade deficit would boost domestic demand and GDP by about $500 billion and add 5 million jobs.

One other important issue related to outsourcing is of hidden costs of outsourcing. It is being said that, companies become so obsessed with outsourcing that they often overlook the hidden costs of outsourcing, such as the cost of selecting a vendor, cost of transition, cultural cost and don't review their decision outsourcing at regular intervals, and this affects their profits.

The difference between total landed cost and prices, and all of the cost factors are failed to be considered by them which are associated with outsourcing.

Those overlooked factors- the hidden costs and risks of outsourcing, are not considered or even recognized in the outsourcing strategies of most organizations. However, they are very real costs that can represent anywhere from 14% to as much as 2x-3x+ of total production cost. Economics of outsourcing keeps on changing, oil prices, natural gas rates, transportation and freight costs, coordination and third-party costs, these are the costs which change daily. But the irony is, most of the outsourcing decisions have not been revisited since they were implemented 10-15 years ago. Over 50% of outsourcing decisions need to be revoked at in terms of short term and long term feasibility. Companies should take a fresh look at their current strategies and policies and be sure they understand the true costs of outsourcing.

We saw that how companies overlook the important issues like inappropriate outsourcing and hidden costs of outsourcing, these are very important issues which need to be kept in mind while outsourcing, otherwise, companies would go on claiming that we have cut down our costs by outsourcing our activities but reality would be something different. Overlooking of these factors can harm the economy, by relative GDP loss.

## III. How unemployment can cause economic downturn and whether outsourcing really causing unemployment:

People say that outsourcing has two effects on the country which is outsourcing its activities, one is, it leads to economic growth by making its companies more competitive, and other is when companies outsource their activities, jobs get outsourced thereby generating unemployment in the economy. And this debate is being often shown as a debate between economic growth and unemployment. It is believed, that, economic growth will continue to rise and unemployment will have no effect on economic growth because due to outsourcing companies' profits are increasing. But by saying this, are we not forgetting the Keynesian theory of demand? Which says, the decrease in demand can cause the economic downturn. So here, when unemployment is rising in an economy, people's income level is falling, their purchasing capacity is contracting, thereby causing the problem of demand which can lead an economy towards the downturn.

To deal with outsourcing, policy challenge is to construct institutions that ensure stable flows of demand and income, thereby addressing the Keynesian problem while preserving incentives for economic activity.

So, now the question arises that whether outsourcing really causing unemployment absolutely.
When a company offshore its activities, then, they will not, they cannot, take all the labour from their country to work there. So, it is obvious, that some jobs will seem like going away.

A senator asserted that at an alarming rate the United States is losing jobs since 2001, 2.7 million manufacturing jobs have been lost and in the next fifteen years the number of jobs which may be sent overseas is 3.3 million.

Companies, offshoring their activities and jobs going away is just the one side of the coin. Let's look at some arguments which show us the other side of the coin.

A zero-sum game is treated outsourcing as by most of the people. The country which is outsourcing its activities one foreign worker replaces one worker of that country. But global dynamic economy's working doesn't work on this concept.

At foreign subsidiaries overseas when Unites states firms hire lower-cost labour the parent companies of those companies to support extended operations hire even more people in the United States. By 2.8 million jobs between 1991 and 2001, employment at U.S. multinationals foreign subsidiaries rose, in the U.S. employment at their parent firms during the same period rose by 5.5 million jobs. Nearly two new jobs were created in the United States for every job outsourced to other countries.

Most of the jobs which are getting outsourced, the people of the country from which they are getting outsourced don't want to do such kind of jobs.

David Poole, Vice President and head of Americas Business Process Outsourcing was asked in an interview, regarding offshoring call centre jobs from the US he answered that offshoring call centre jobs is not really increasing unemployment, because, it does not work that a lot of Americans actually want to do and not only just call centre jobs, most of the jobs which are outsourced are of such nature. Moreover, there is a greater supply of educated, well-qualified resources able and willing to do this kind of works in some offshore locations.

By using the Keynesian demand theory, we first saw, how this problem of unemployment, which is often being shown as the major consequence of outsourcing, is not just related to the issue of society's welfare, it can cause the economic downturn, as well. Then we saw, two sides of this unemployment issue, one, the obvious one, companies are outsourcing and jobs are getting away. The other, which showed that in absolute terms jobs are not getting away, zero-sum-game-theory was being challenged, and we found, with every job being outsourced abroad, new jobs are getting created, we also saw that reality is, jobs which are being outsourced, people don't want to do such jobs.
So by that discussion, we found that till now outsourcing is not causing the problem of unemployment, in absolute terms. By keeping in mind the Keynesian theory of demand, we can say that till now there is no evidence that outsourcing can lead an economy towards the downturn. However, we would like to add that, as the technology is innovating, globalization is rising, in the coming years, there is a possibility that, outsourcing will take place like never before. And with that possibility, there is also a possibility that, if outsourcing would be done blindly, then it can, perhaps, generate, the Keynesian problem of demand in some economies, by increasing unemployment.

## IV. Answer of the question "when politicians say that they will restrict outsourcing are they not promising to make their countries poorer":

If we would answer this question by just keeping in mind the findings of the first part, which says restricting outsourcing, can have drastic effects on the economy, making companies less competitive, by increasing their costs, decreasing their efficiency and decreasing their profits, thereby making the country's GDP to fall and ultimately making the country poorer.

Then our answer would be, that yes, restricting outsourcing, would certainly make a country poorer. However, that would be an incomplete answer to this question.

The complete one would be, restricting outsourcing would certainly make a country poorer, but if blind outsourcing would be done, and issues like inappropriate outsourcing and hidden costs will be overlooked then outsourcing can backfire and can lead to a fall in GDP, ultimately making a country poorer. Not just this, if blind outsourcing would be followed, then till now facts don't really suggest, but theory suggests that there is a possibility, that, in future, outsourcing can cause unemployment problems, and Keynesian theory of demand can come in to play, causing not just a GDP fall, but can cause a severe downturn in the economies.

So what is needed to be done is to tame this horse of outsourcing, by reviewing the decisions of outsourcing at regular intervals, carefully analysing issues like hidden costs of outsourcing and inappropriate outsourcing, and wherever needed putting calculated, careful restrictions, also.
Basically, the need of the hour is to follow the saying that says "A wild horse can do a lot of damage, but a bridled horse can be an invaluable asset." Posted by Proud UAW Member in response to "politics of Globalization" at www.thomaspalley.com, December 27, 2005.

## V. Conclusion:

In the first part, we saw examples of Apple, Walmart and steel industry of U.S., and found that internationally trading companies are earning huge profits by outsourcing their activities, any policy of restricting outsourcing can increase their costs, decrease their profits, ultimately making them less competitive.

In the second part, the issues, like inappropriate outsourcing and hidden costs of outsourcing, which are often been overlooked by the companies while making their outsourcing decisions, were discussed, and it is being found that, if these issues are not been properly looked at then they can cause outsourcing in a relative fall in GDP and increase in unemployment.

In the third part, we saw how "outsourcing causing unemployment" is not just a society's welfare issue and through the Keynesian theory of demand, it can cause a downturn in an economy as well. Further, we saw that apparently, due to outsourcing jobs seems to go away but in absolute terms, they are not going away.

In the fourth part, the answer to the question "when politicians say they will restrict outsourcing, aren't they promising to make their countries poorer" was answered, in the manner that restriction in outsourcing would surely make a country poorer but blind outsourcing can also result in making a country poorer.

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