

# Chapter 5.21

## Sourcing and Outsourcing Arithmetic

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### ABSTRACT

This chapter studies outsourcing from the United States to India. First, we show that outsourcing is not taking most jobs out of the United States. Second, we argue that outsourcing does not contradict trade theory. Third, we analyze how India has come to occupy a preeminent position in outsourcing. Fourth, we show that the Indian dominance is likely to continue well into the next decade. Finally, we discuss some risks associated with outsourcing.

### INTRODUCTION

The Greek philosopher Seneca said over 2 millennia ago, “There is nothing new under the sun.” Outsourcing is nothing new either. It is well known that the Roman Empire had outsourced tax collection in far-flung places. As a result, a

recurrent theme in Edward Gibbon’s historical treatise, *The History of The Decline and Fall of the Roman Empire*, is that the decline is attributable, to some extent, to outsourcing.

In the eighteenth and the nineteenth century, England outsourced, to private contractors, the maintenance and operation of streetlights, the management of prisons, and the repair of public highways. However, historically, most outsourcing has been associated with “non-essential” services. PriceWaterhouseCoopers defines outsourcing as “the long-term contracting out of non-core business processes to an outside provider to help achieve increased shareholder value” (<http://www.pwcglobal.com>). On the other hand, Gartner Group defines it as “the delegation of one or more IT-intensive business processes to an external provider that, in turn, owns, administrates and manages the selected processes based on defined and measurable performance metrics.” Unlike PriceWaterhouseCoopers, Gartner avoids any

reference to noncore business, it focuses instead on information technology (IT). Outsourcing of strategic business services is relatively new. It started with Eastman Kodak outsourcing information technology (IT) to three external partners in 1989.

During the 2004 presidential election in the United States, it riled the political world so much that the Coalition for Economic Growth and American Jobs suggested that instead of calling the phenomenon “outsourcing,” we should use a more neutral term, “worldwide sourcing” (Koffler, 2004).

The loss of white-collar jobs due to outsourcing has prompted many U.S. state governments to ban foreign contractors from bidding altogether. In a telling example, the governor of Indiana canceled a \$15 million contract with an Indian company to process state unemployment claims. The next-lowest bidder, an American firm, was eventually given the same job for \$23 million (Maranjian, 2004).

In this chapter, *we focus on outsourcing from the United States to India because the United States has become the largest outsourcing country whereas India has become the largest host country*. In that context, we first put outsourcing in proper perspective in terms of job losses. Second, we discuss outsourcing in the context of trade theory. Third, we discuss the reasons and the types of outsourcing. India has become the focus of the entire outsourcing debate because a substantial number of outsourcing contracts in the past 10 years between developed and developing countries have gone to India. Therefore, we discuss how and why India has become such an important source of outsourcing. Finally, we discuss outsourcing risks.

## **OUTSOURCING IN PERSPECTIVE**

In 2002, John C. McCarthy of Forrester Research estimated that over a period of 15 years, some

3.3 million jobs would go offshore as a result of outsourcing (McCarthy, 2002). Of this 3.3 million, 2.3 million jobs are going to go to India. That is, over 60% of these jobs are going to migrate to India. These figures created a political uproar.

To take one example, in 2003, Delta Air Lines outsourced some of its reservation functions to two Indian companies. It saved about \$12 million in costs by the end of 2005. The service providers handled simple reservations, while complex ones were taken care of by agents based in the United States. There were protests, leading some states in the United States to *legislate against* such outsourcing for *government contracts*. What was little noticed was the fact that the job losses would happen over a period of *15 years*.

We need these figures in perspective. The Bureau of Labor Statistics estimates show that seasonally adjusted job losses *every quarter* during 1995-2003 were in the range of 7 and 8 million jobs. Thus, outsourcing is and will stay small potatoes in terms of job losses and creation in the United States. Of course, when trade in services causes job losses domestically, a similar number of jobs are created at the same time. By the same token, it does not make sense to concentrate job losses due to *import* of services alone. We need to examine the corresponding figures for *export* of services. The total value of *export* of private services amounted to \$131.01 billion in 2003, whereas the *import* of private services was worth \$77.38 billion in 2003. Thus, the U.S. had a \$53.64 billion surplus in the trade of services. Farrell (2003) estimates that 1 dollar spent on outsourcing will result in 58 cents of company cost savings, 5 cents of additional U.S. goods and services bought, 4 cents for repatriated earnings (when the outsourcing is to the subsidiary of a U.S. company), and 45 to 47 cents from new jobs created by the outsourcing company. Therefore, at the *global* level, \$1 on outsourcing produces \$1.12-\$1.14 worth of benefits (Phillips, 2004).

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