Observations

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<< were fairly evenly spread across all wage levels. But this time, the job downturn has fallen heavily on the highest wage industries. Ranking U.S. industries from highest to lowest pay, the top-paying 10 percent (such as telecom, software, finance, and certain segments of durables manufacturing) accounted for over a quarter of the total job losses.

Thus, regions with heavy shares of high-wage technology industries, which benefited greatly from the boom of the late 1990s, are now paying a heavy price. A full 16 percent of Massachusetts jobs are in the high-paying industries that comprise the top 10 percent of the nation's employment. Because of this high concentration, and because job losses in one sector spill over into other sectors, the state lost nearly 6 percent of its employment—the largest statewide decline in the nation. Even worse, the San Francisco Bay Area, where 22 percent of jobs are in the top decile, has seen almost a 10 percent overall drop in employment. Still, despite the heavy toll, these job losses are no worse than would be expected given the nationwide weakness in top-paying industries. As these sectors improve, it's likely that the local economies dependent upon them will strengthen, too.

But not all hard-hit regions are like Massachusetts. Heavily industrial Michigan and Ohio have also been hurt by losses in traditional manufacturing sectors such as metals, plastics, machinery, and auto parts--industries in the 50th to 80th percentiles of wages. They have lost more than 3 percent of their employment statewide, double the national average. The combination of large overall employment losses and a lower concentration of the highest-wage industries has placed these states in perhaps a more difficult position. Indeed, as the national jobs recovery continues to gather momentum, states like these may find it harder to share in the nation's growth.

—*Yolanda Kodrzycki and Nelson Gerew*

Outsourcing jobs overseas: perspective

ALMOST DAILY, the press alerts us that yet another major U.S. company has laid off several thousand U.S. workers while moving back office or skilled programming work, a call center, or even the whole corporate HR function to China, India, or other low-wage countries. Media analyses claim that anywhere from 250,000 to 500,000 business service jobs moved abroad between 2001 and 2003, at the same time that total U.S. nonfarm employment remains down almost 500,000 from its most recent peak. Indeed, although the U.S. economy has finally begun creating jobs—2.1 million in the past 12 months—this recovery has witnessed the weakest job growth of any upturn since World War II. Voters, policymakers, and the media are all calling for measures to stem the job flow.

Professional jobs are starting to migrate overseas, as manufacturing jobs did before them. But this only accounts for a small portion of job losses in the recent recession.

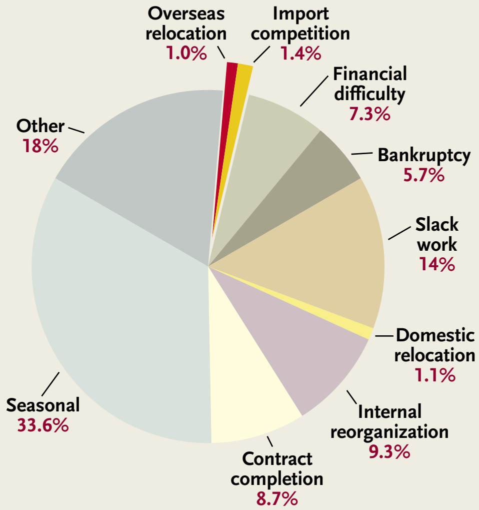
Outsourcing work to foreign countries, *per se*, is nothing new. We understand that this is part of

By Jane Sneddon Little

Illustration by Dan Page


A cause for concern?

Home-grown job loss



Domestic, not international, economic changes are behind most layoffs. Only 2.4 percent of extended mass layoffs during 2001 to 2003 were due to overseas relocation or import competition.

SOURCE: Bureau of Labor Statistics

the economy's evolution as employment shifts from agriculture to manufacturing to services and knowledge-based activities and as products mature through their life cycles. Historically, at each successive stage, U.S. workers have shifted to "better," more productive, higher-wage jobs in burgeoning industries or the high-value-added parts of mature industries.

What is raising new concerns is the shift to foreign outsourcing in services, including the export of moderately high-skilled, white-collar jobs. As countries like China and India have accumulated human capital, at least some of the jobs going overseas are the better jobs—the professional jobs in programming or software design, in accounting or microeconomics or radiology, in the "new" service industries where the United States was supposed to have a comparative advantage.

But a careful analysis shows that media reports may have exaggerated the economic impact of foreign outsourcing. Many conflated the *gross* number of jobs lost through outsourcing with the *net* number lost economy-wide, overlooking the jobs created here in the U.S. thanks to outsourcing abroad. In fact, outsourcing can probably only explain a small share of our slow "job-loss" recovery. To explain why job growth was so long delayed in the current upturn, we need to look much further.

Between 2001 and 2003, 143 million U.S. workers were separated from their jobs—56 million due to involuntary layoffs and discharges, plus 87 million due to quits and other reasons. The separations were largely offset by 141 million hires, but given the recession and sluggish recovery, the outcome was a small negative—a net decline of 2 million jobs over the period.

How much of this job loss was due to foreign outsourcing of business and professional services—the kinds of job losses attracting the most attention? It's difficult to say precisely, but we do have some clues. One comes from the Bureau of Labor Statistics, which collects data on mass layoffs—those layoffs involving 50 or more workers within a five-week period and lasting more than 30 days. According to the BLS, import competition and job relocation overseas explained just 2.4 percent of all mass layoffs in 2001 through 2003 (about the same share, incidentally, that these two factors accounted for in the boom years of 1998 and 1999). Some outsourcing-related layoffs, of course, may have been mistakenly attributed to other causes. But even tripling or quadrupling the 2.4 percent share still leaves domestic developments like business restructuring and slack demand explaining the bulk of recent mass layoffs.

Now assume that job relocation and import competition accounted for 2.4 percent of all 56 million layoffs made in 2001, 2002, and 2003. This suggests that outsourcing led to about 1.3 million layoffs over those three years, of which perhaps 200,000 or so were in business and professional services. Add to this some outsourcing-related job loss that may have occurred through attrition, and it's no wonder that everyone knows of someone whose job has gone to India or the Philippines.

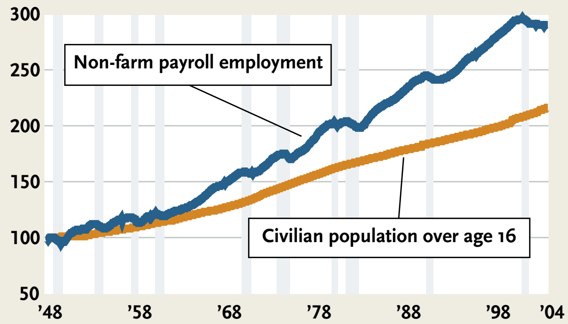
But, to put that 200,000 figure in perspective, the business and professional services industry experienced 8.5 million layoffs during the last downturn. Foreign outsourcing only explained a small share of them. And while hiring rates fell more in business and professional services than in the average U.S. industry, they also fell more quickly than average in wholesale and retail trade, transportation, entertainment and recreation, and accommodations and food services—all industries not well suited to foreign outsourcing. Once again, it appears that domestic forces, not outsourcing, are largely to blame.

Furthermore, it's easy to forget that outsourcing has led to U.S. hiring as well. Foreign call centers rely on U.S. software, U.S. communications equipment, and U.S. air conditioners, while their newly affluent young workers buy U.S. jeans and

Job growth in the long run

Despite growing exposure to trade, U.S. jobs have always grown faster than the population.

INDEX: JAN 1948 = 100



NOTE: Shaded areas represent recessions as dated by the National Bureau of Economic Research.
SOURCE: Bureau of Labor Statistics

BOHEMIAN NOMAD PICTUREMAKERS/CORBIS

Chinese firms now export electronic components and back-office services that we once produced at home. What does this mean for the U.S.?

The China question

In the debate about outsourcing work to foreign countries, China has emerged as a particular concern. The specter of almost 750 million Chinese workers, eagerly competing for a wide spectrum of U.S. jobs, weighs heavily on the minds of politicians, media analysts, and the American workforce. The fact that China has around a $137 billion annual trade surplus with the U.S. and accounts, by itself, for one-quarter of our huge trade deficit just adds to growing concerns about U.S. workers' ability to compete with China's increasingly skilled but low-cost labor force. China caused a further stir recently when it (briefly) became the top destination for foreign direct investment flows in 2002, displacing the United States from its traditional first-place position.

But let's keep China in perspective. For one thing, China's large share of our trade deficit is not really that unusual. Western Europe commands a 20 percent share today. And in the mid 1980s, Asia's Newly Industrialized Countries (the NICs) accounted for about the same share that China does now, while Japan's share was almost 40 percent. But as China's share has grown over time, Japan and the NIC's shares have shrunk—in part because Asian firms have also been outsourcing to China. Chinese workers now assemble components imported from the rest of Asia and export these goods to the United States—goods that Japan and the NICs once exported directly.

What's more, China's huge labor cost advantage probably won't last. In the mid 1980s, Japanese manufacturing wages and benefits were about half of their U.S. equivalent, but lower labor productivity meant that its unit labor costs (which take into account both compensation and productivity differences) were about 70 percent of U.S. levels. Korean compensation measured 10 percent of U.S. manufacturing compensation, while its unit labor costs were only 40 percent of the U.S. level. Fifteen years later, in 2000, Japan's unit labor costs had risen to match those in the United States, and Korea's unit labor costs had closed to within 80 percent of the U.S. base. China's unit labor costs may be low today, but it is a good bet that they will not stay that way.

Just as economic development in the U.S. and Japan helped to raise global living standards, so too should China's emergence as a developed economy be widely beneficial to the U.S. economy. Many individuals will inevitably face painful adjustments as some jobs and industries continue to move offshore. But the resulting increase in U.S. real incomes should allow the many who benefit to help those who are harmed. Such measures might include broadening the scope of trade adjustment assistance, increasing the portability of pension and health benefits, and encouraging firms to invest in human as well as physical capital.

By contrast, the large gap between Chinese and U.S. students' skills in math and science probably should raise concerns about this country's ability to maintain its technological lead in future years. But we cannot blame China for that.

U.S. DVDs. And foreign computer and business service firms are now "insourcing" to the United States; for instance, buying or establishing a U.S. affiliate so that they can better manage their interactions with U.S. customers.

Foreign outsourcing has also helped U.S. firms to lower their computer hardware, software, and other input costs by obtaining these items offshore. These cost reductions have given the U.S. economy an indirect boost by allowing firms to attract business they otherwise would not have had and therefore to employ people they otherwise could not have employed. Analysts do not know how many outsourcing-related hires have offset the 1 million outsourcing-related layoffs over this period. But it is clearly wrong to compare the estimated 1 million gross layoffs caused by outsourcing with the net loss of 2 million jobs between late 2000 and late 2003. That would be like comparing an apple with half an orange.

In truth, it should be no surprise that the economic impact of these recent job shifts has been pretty modest to date. For one thing, imports of "other private services," which include the business and professional services of most interest in the current debate, amounted to only 0.7 percent of GDP in 2003, while U.S. imports of "other private services" from all of developing Asia (not just China) amounted to less than 0.1 percent. That's far too small to have a significant impact on U.S. output or job growth.

Second, while the U.S. is running a huge trade deficit overall, the nation continues to export more services than we import. Indeed, our trade surplus in "other private services" is growing not just overall but vis-à-vis developing Asia as well. Clearly, U.S. workers remain highly competitive in high-value-added services—even in Asia.

Most important, these job flows must be viewed in the context of the truly extraordinary dynamism of the U.S. economy—an economy in which almost 1 million people leave an old job and almost 1 million people start a new one every week. From time to time, over periods of a year or two, job separations may slightly exceed hires, and employment falls. But over the long haul since World War II, hires have exceeded separations and employment has grown decade after decade, despite our increased exposure to international trade. This relationship held during the period of U.S. business expansion in Europe in the late 1960s and 1970s, when the Europeans were sure that Americans would wind up owning all of Europe. The relationship also held in the 1980s, when the land under the Emperor's palace in Tokyo was worth as much as the state of California and Americans thought the Japanese might buy up much of the U.S. And it held in the NAFTA years, despite that giant sucking sound. None of these episodes had any perceptible lasting impact on long-term U.S. job growth. The same will surely be true of the developing world's emergence as an economic power. ❊

Rules of the game

TRADING & EXCHANGES: *Market Microstructure for Practitioners* is hefty both in size and in merit. Written by Larry Harris, a prominent financial economist at the University of Southern California currently serving as the chief economist for the Securities and Exchange Commission (SEC), *Trading & Exchanges* is a must-read for anyone interested in the good, the bad, and the ugly of securities trading. It clearly explains the details of the instruments, the institutions, the rules, and the motives that define the world of the equity trader. Harris illuminates the features of an interactive system in which the often-conflicting interests of traders and the market's institutional arrangements affect the prices of securities and define the winners and losers in the trading game.

Trading & Exchanges: Market Microstructure for Practitioners
By Larry Harris
599 pages plus extensive bibliography and index
Oxford University Press, 2002

By Peter Fortune
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