Executive Summary

This article focuses on offshoring—the transfer of certain jobs from the United States and other wealthy nations to developing nations. Offshoring has become a necessity in order for multinational companies to reduce the cost of doing business and maintain comparative advantage in the global marketplace. Initially, manufacturing jobs were offshored; however, the jobs currently being transferred to developing nations are certain service sector jobs. These are jobs that can be performed remotely and that do not require one to one interaction. In deciding whether to offshore service sector jobs, businesses must consider a number of factors including cost, turnover rates, risk, infrastructure and the availability of qualified personnel. The following article provides an overview of offshoring and discuss some of the implications for the U.S. labor force.

Overview

The integration of the world’s economies has led to an increase in offshoring; the transfer of jobs from wealthy nations to developing nations. In previous decades, offshoring was limited to the manufacturing sector; however in recent years, service sector jobs like customer service jobs and call center activity have also been sent abroad. In order to better understand this development, it is necessary to differentiate offshoring from outsourcing. Offshoring essentially concerns a variety of functions that can be performed by a firm in another country. This includes a company that establishes a foreign subsidiary or a business that transfers these tasks to a foreign third party enterprise (Harrison, 2006).

Outsourcing, on the other hand, is the purchase of services by one firm from another. A U.S. firm, for example, can outsource the production of goods, such as car parts, as well as services, such as customer service positions. In some cases, U.S. based manufacturers of electronics may contract with other U.S. businesses to produce electronic components. This is referred to as outsourcing. At the same time, transferring production of these components to a manufacturer in China or India would be considered offshoring (Harrison, 2006).

Benefits of Offshoring

A firm that increases its profits by decreasing its labor costs through offshoring will improve its ability to compete in the global economy. In the U.S., firms that establish foreign subsidiaries are referred to as multinationals. In addition to establishing a subsidiary in a foreign country, a company may also choose to invest in a company that is not based in the U.S. Further, the ownership of 10% of a company abroad by a U.S. multinational is referred to as direct foreign investment. Some contend that establishing foreign subsidiaries and direct foreign investments results in job losses in the U.S. However, many economists believe that the number and availability of jobs in an economy is determined more by macroeconomic factors than by international competition (Harrison, 2006).

Other beneficiaries of offshoring are those nations where jobs have been transferred or where there has been an increase in direct foreign investment. In particular, India, China, the Philippines and a number of Latin American and Eastern European countries have reaped the rewards of offshoring. Further, in addition to manufacturing jobs that were offshored in previous decades, service sector jobs are now also being offshore to these countries including clerical positions, sales and marketing jobs,
many workers in India speak English. Initially, jobs offshored to India as a Leading Offshoring Sight

While a number of foreign countries have been the beneficiaries of outsourcing, India has become a leader in the international offshore market. This is largely the result of the fact that India has a well-educated and highly skilled workforce – moreover, many workers in India speak English. Initially, jobs offshored to India included data entry and minor software development; however, by the 1990’s, these roles expanded into larger software projects, back office operations such as accounting, and even running information technology departments for many organizations. Today, India’s workforce has become more skilled and refined so that its current services include engineering, research and development, aircraft design, as well as microchip development; in fact, approximately 30% of jobs that are offshored are now transferred to India (Dolan, 2006).

In addition to jobs being transferred to India, jobs are also being offshored from India to other countries. Many staffing agencies based in India are establishing offices in other countries where offshore markets are emerging. Outsourcing work to an organization that subsequently outsources the work to a company in another country is referred to as the global delivery model. Understanding this model enables a company to seek locations for offshoring in a region or town that will grow in conjunction with their presence in the area. In the final analysis, offshoring will continue to be a model for businesses in the global economy. Multinationals will continue to seek skilled workers at lower wages as well as new markets for their goods, products and services (Dolan 2006).

Applications

Transfer from Manufacturing towards the Service Industry

While there are many benefits that multinational companies can derive from transferring jobs to other developing nations, offshoring is a contentious topic in the U.S. and other wealthy nations. Some believe that offshoring has resulted in significant job losses and that the labor standards in developing nations are lower than in wealthy nations. On the other hand, there is another school of thought that claims increased employment overseas has led to increased employment domestically. This is so because the cost savings provided by offshoring combined with technological advances have increased productivity in all sectors and has also enhanced the growth of the services sector. However, what is not in dispute is the fact that the American economy and the economies of other wealthy nations like Great Britain, Japan, and many Western European nations have been undergoing a dramatic change away from manufacturing toward servicing (Blinder, 2006).

Rather than producing manufactured goods such as automobiles, durable appliances, and mechanical equipment, these countries now provide more services such as health services, educational services, hospitality and leisure services, financial services and the like. These jobs are known as personal service jobs. This is so because personal services are those that require face-to-face contact or human interaction. At the same time, technological advances are also leading to improvements in global communications and many personal services are now readily delivered electronically over long distances without adversely affecting the quality of the service being provided. These services are termed impersonal services and include such jobs as customer service

Considerations for the Offshoring of Operations

There are a number of factors that a business needs to consider when deciding where to offshore jobs and these include cost, turnover rate, available skilled workers, risk assessment, accessibility and infrastructure. While cost is a significant determinant in a businesses decision to transfer jobs abroad, location is also critical to the future of a company’s overseas investment. In this regard, companies often focus on regions with good colleges where skilled employees are available at low wages. In addition, companies also seek out locations that are close to airports so that personnel from outlying areas can be flown in for training. This, in turn, leads to the development of the infrastructure (i.e., power supply, real estate development, telecommunications and transportation) and further encourages other companies to offshore jobs. This is so because these companies will derive residual benefits of offshoring that result from developing an infrastructure and establishing a pool of skilled workers. Development of infrastructure also mitigates the risk of future involvement as it elevates these regions out of poverty and helps to stabilize the government (Farrel, 2006).

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positions as well as radiologists. Further, international trade of new products and services can be the impetus for improvements in productivity, and this will have an impact on a company’s comparative advantage (Blinder, 2006).

**Comparative Advantage**

Comparative advantage is a fundamental economic theory that explains why it is beneficial for two parties – whether they are countries, regions or businesses, to trade their goods and services. A key factor in determining comparative advantage is how readily the two regions can produce different goods that will subsequently be traded. The concept of comparative advantage is the basis for a business or region to choose a good or service to specialize in producing. If the U.S. can produce certain goods or services at lower cost than a foreign country, and if the foreign country can produce other goods and services at a lower cost than the U.S., both countries may gain from trading each others’ relatively inexpensively produced goods and services (Blinder, 2006).

For example, Great Britain once held a comparative advantage in the manufacturing of textiles, but that advantage eventually shifted to New England, and with that, jobs were transferred to the U.S. However, China and other low wage countries now enjoy a comparative advantage in textile manufacturing, and jobs that were once considered “American” have been offshored to these countries. Further, technological innovations that have arisen in the information age have had a significant impact on comparative advantage and in determining which goods and services can be traded internationally. Traditionally, any manufactured good was considered tradeable. Manufactured goods are goods that have been processed in any way, and these include intermediate and industrial goods as well as final goods. On the other hand, anything such as services or real estate was thought of as non-tradeable (Blinder, 2006).

**Results of Improving Technologies**

Because of the digitalization of information and vast improvements in telecommunications, however, many services that were considered non-tradeable can now be delivered electronically around the globe. This is especially relevant for customer service, call service, technological and laboratory functions. The continued shift toward personal services in wealthy nations will require economic and social adjustments. One potential result of this trend will be that more people seek positions in the personal services. A key factor in determining comparative advantage is how readily the two regions can produce different goods that will subsequently be traded. The concept of comparative advantage is the basis for a business or region to choose a good or service to specialize in producing. If the U.S. can produce certain goods or services at lower cost than a foreign country, and if the foreign country can produce other goods and services at a lower cost than the U.S., both countries may gain from trading each others’ relatively inexpensively produced goods and services (Blinder, 2006).

The necessary adjustments that will be required of the wealthy nations will put pressure on those societies to adapt. The U.S. for example, currently enjoys a comparative advantage in non-tradeable services due to its well-established health and education services, professional and business services and leisure and hospitality services. However, the U.S. will need to reorganize its workforce in order to maintain this advantage. There could be changes that result in the country having more divorce lawyers than contract lawyers, since the latter is the type of service that could be vulnerable to offshoring. In health services, while internists will still be needed, many companies have begun offshoring radiology positions. These transformations, in turn, will require changes in the country’s educational system in order to prepare workers for jobs that will continue to exist (Blinder, 2006).

Further, as more impersonal services are offshored, there will be a need for trade adjustment assistance in the form of social safety nets such as unemployment compensation, job retraining, pensions and public assistance. In this regard, the U.S. is not as prepared as nations in Western Europe since those countries have historically had more robust entitlement programs. At the same time, these programs are expensive and the question remains as to whether those nations will be able to afford additional social programs (Blinder, 2006). While there are challenges facing the U.S. and other wealthy nations, the practice of transferring jobs to developing nations will continue as multinational companies seek skilled workers and new markets.

In addition, offshoring has been concentrated in a few regions of countries where jobs have been transferred. Because of this concentration, wages have been escalated and there is a high turnover rate as employees move from one offshored job to another. Therefore, the determination of where to transfer jobs is no longer driven by solely by wages. Today, businesses also need to consider wage inflation trends, future labor supplies and recruitment costs (Farrell, 2006). Companies seeking to offshore jobs will require access to suitable workers or professionals. These are individuals who are university graduates, have a number of years of experience, language skills, and technical knowledge.

Moreover, these individuals will need to be capable of interacting in a corporate environment. In this regard, the availability of suitable workers varies widely from country to country, and a country that has a large and accessible pool of suitable workers will enjoy a comparative advantage in attracting offshored jobs. While India has been a primary location for offshoring, such countries as South Africa, Morocco, and countries in Eastern Europe are emerging as markets for outsourcing. Moreover, as the world economies continue to integrate because of the forces of globalization, offshoring will continue to be a reality. In addition, many multinational corporations are seeking to create 24/7 development cycles, gain access to new markets, and better proximity to new customers (Wadhwa, 2006).

**Critical Insights**

**Evolution of Free Trade & its Effect on Offshoring**

The challenges that offshoring poses to wealthy nations like the U.S. as well as developing nations are numerous. For the United States, multinational companies will continue to outsource and this will have a fundamental effect on the nation’s economy as well as the structure of its labor markets. As mentioned above, the U.S. has shifted away from a manufacturing-based economy to a service-based economy. The initial transfer of manufacturing jobs actually began decades ago and this trend was accelerated.
by the evolution of free trade. This is particularly evidenced by the implementation of the North American Free Trade Agreement (NAFTA) in the 1990’s.

NAFTA is a free trade agreement entered into among the U.S., Canada and Mexico that essentially eliminated duties on various goods and products that were already being traded among these three nations. In short, NAFTA resulted in the transfer of certain manufacturing jobs to Mexico (Field 2004). Another significant development in free trade was the relationship between the U.S. and China and the establishment of the World Trade Organization in 1995. This organization was established by the Uruguay Round of agreements under the General Agreement on Tariffs and Trade. After China was admitted into the WTO, there was an increase in trade between China and the U.S. and a number of manufacturing jobs were also outsourced by U.S. based multinationals to companies in China (Bury, 2004).

As these trends continue to develop, the U.S. economy continues to transfer to a service-based economy that will increasingly focus on personal services rather than impersonal services. At the same time, there will continue to be a need for low skilled workers, and this especially will be the case in the hospitality, construction and agriculture industries. This has and will continue to contribute to an influx of migrant workers to the U.S. from Mexico and Central America. (Quan, 2005).

Challenges Faced by the US

As the economy has continued to evolve, the types of service based jobs that will remain in the U.S. (and other wealthy nations) will be personal service jobs that require face-to-face contact. At the same time, more and more impersonal service jobs, like customer service jobs, and medical and information technology will be transferred abroad. These trends will affect wages in the U.S. as labor is reallocated (Farrel, 2006). Moreover, as technological advances continue, the types of service positions that can be offshored will continue to change. In this regard, some economists have expressed concern that America’s ability to compete, especially as it relates to research and development, will be challenged.

In order for America to maintain a competitive edge, it will need to keep critical research and development functions onshore. For example, there will be a continued need for well educated engineers. China and India have a large supply of entry level engineers, and many U.S. based multinationals will continue to outsource engineering jobs to these countries. At the same time, other companies are tapping into this talent pool by bringing people from India and China to work in information technology divisions of U.S. based companies. However, American workers do have certain advantages that can help to retain these highly skilled jobs. These advantages include their communication skills, understanding of the market, education and training and creativity. In this regard, it can be said that having a highly skilled work force along with these aforementioned qualities gives America a comparative advantage with respect to personal services sector jobs (Wadhwa, 2006).

As it has been the case with other jobs, however, technological advances may transform certain personal service jobs into impersonal service positions that can be delivered electronically throughout the world. For example, while radiology positions have already been subjected to offshoring, other positions in the healthcare services sector, such as medical lab technicians may also one day be offshored. Another area where America enjoys a comparative advantage is in the financial services sector, but advances in technology may have an impact here as well (Blinder, 2006).

In the final analysis, offshoring will continue to evolve and as it does it will present other challenges to the U.S. economy. The educational system will need to focus on training workers for jobs in the personal services sector. Moreover, other factors like influx of workers from Mexico and Central America is presenting challenges for U.S. workers who have previously filled these roles because migrant workers are performing these functions for lower wages. Finally, as the world’s economies continue to integrate, there will be a need for people in the U.S. to develop stronger foreign language skills. Many of the highly skilled workers in India and China can speak English, and in some of the emerging offshoring markets in Eastern Europe, many of the highly skilled workers are fluent in a number of languages. The question remains as to how well equipped our society is to meet these challenges.

Terms & Concepts

**Comparative Advantage:** That strong suit which makes us individual and unique; can be natural or man-made.

**Direct Foreign Investment:** An ownership interest of 10% by a domestic organization in the business of a company in another country.

**GATT:** The General Agreement on Tariffs and Trade originally entered into among many western nations in 1947 for the purpose of eliminating barriers to world trader.

**Global Delivery Model:** The concept of outsourcing work to an organization that subsequently outsources the work to a company in another country.

**Impersonal Services:** Those that can be easily sent and received electronically.

**Multinationals:** A company that is headquartered in one country and that has established divisions of subsidiaries in a foreign country.

**NAFTA:** The North American Free Trade Agreement entered into among the U.S., Canada and Mexico that eliminated trade barriers and contributed to the outsourcing of manufacturing jobs.
**Offshoring**: The shifting of jobs from wealthy nations to developing nations.

**Outsourcing**: The purchase of inputs or services by one business from another.

**Personal Services**: Services that require face-to-face contact or human interaction.

**Uruguay Round**: Free trade agreement entered into in accordance with the General Agreement on Tariffs and Trade that led to the establishment of the WTO.

**WTO**: World Trade Organization which is responsible for overseeing the agreements of the Uruguay Round of free trade talks.

**Sources**


**For More Information**


Edited by Richa S. Tiwary, Ph.D., MLS

Richa S. Tiwary holds a Doctorate in Marketing Management with a specialization in Consumer Behavior from Banaras Hindu University, India. She earned her second Masters in Library Sciences with dual concentration in Information Science & Technology, and, Library Information Services, from the Department of Information Studies, University at Albany-SUNY.