NATIONAL FOUNDATION FOR AMERICAN POLICY

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PROPOSED RESTRICTIONS ON GLOBAL SOURCING CONTINUE AT HIGH LEVEL IN 2005

Within the first three months of 2005, more than 112 bills to restrict "outsourcing" have been introduced in at least 40 states. That represents more states and bills than last year at the same time.[1] Why has this trend to restrict international trade in services persisted at the state level? Are these proposed restrictions a good idea? Are they unconstitutional?

THE ANTI-OUTSOURCING TREND CONTINUES

In 2004, only five anti-outsourcing bills became law and none of them were far-reaching. Republican governors in California, Massachusetts, and Maryland vetoed anti-outsourcing bills, though outgoing New Jersey Gov. Jim McGreevey (D) issued a highly restrictive executive order to prevent state work from being performed offshore.[2] The reasons for the impulse to impose restrictions on offshore outsourcing are understandable, though misguided. Economic factors that created anxiety about "jobs moving offshore" — global competition, increased productivity, and new job creation distributed unevenly across sectors — have not changed in the past six months. In addition, as with other issues, bill sponsors may possess political motivations, such as putting members of the other party in a difficult position.

Most state bills to restrict outsourcing fall into two categories: restrictions on state contract work being performed offshore and measures to limit the use of offshore call centers. Several state legislators also are attempting to prevent personal data from being sent outside the United States, even though existing federal law already permits sharing of data among affiliate entities without regard to geography and provides for recourse against U.S. companies that fail to take appropriate safeguards.

Among the bills to watch this year:

- S. 494 passed the New Jersey Assembly on March 14, 2005. The bill had passed the State Senate last year. At the time of publication, the Governor, who voted for the bill when he was in the State Senate, had yet to indicate how he planned to act on the bill. The legislation prohibits state contract work from being performed overseas. If the bill becomes law, it would be the most far-reaching anti-outsourcing measure in the country.

- Oklahoma Senate Bill 5 passed the State Senate 40-0 on March 14, 2005. The bill would prohibit call centers that receive state contracts to be based outside of the United States.

- Language to restrict call centers is contained in a Mississippi bill (H. 538) that passed the State House.
- Montana Senate Bill 149 would prohibit state contract work from being performed outside the United States. It passed the State Senate 34-16 on January 29, 2005.
- The House in Washington, on March 16, 2005, passed House Bill 2257, which would require state agencies to take into account factors such as whether work would be performed outside the United States when awarding contracts.
- On April, 11, 2005, the Maryland General Assembly voted to override Governor Robert L. Ehrlich's veto of House Bill 514, which would prevent the Governor or the federal government from binding the state to the government procurement rules of an international trade agreement unless the Assembly enacts legislation authorizing it.

FISCAL AND CONSTITUTIONAL PROBLEMS

On the most practical level, limiting competition for state contract work increases procurement costs. This year, Colorado State Senator Deanna Hanna (D) withdrew her bill to prohibit state contract work from being performed overseas after an official budget analysis showed the legislation would cost that state between $28 million and $73 million in the coming year.[3]

In New Jersey in 2003, criticism erupted when a subcontractor for a call center contract for state unemployment services used workers in India. The state government re-worked the contract to place more individuals in New Jersey. The result? New Jersey taxpayers paid, on top of the original contract costs, an additional $900,000 for 12 jobs. "Saving" 1,400 such jobs in the future would cost the state an extra $100 million.[4]

Many anti-outsourcing bills likely would be found unconstitutional. A legal analysis for the National Foundation for American Policy performed by Shannon Klinger and Lynn Sykes, attorneys with Alston & Bird, concluded that state contact bans "are legally suspect…since courts would likely find that such measures improperly intrude on the federal foreign affairs power and violate the U.S. Constitution's Foreign Commerce Clause." Simply put, states are not allowed to make their own trade or foreign policies.[5]

Even if some of these bills (questionably) latch on to the "market participant" theory used by some courts to allow "buy America" laws, the measures still likely place the United States in violation of its international trade obligations.[6] The United States, along with more than 30 other nations, has signed the Government Procurement Agreement, which prohibits state and federal procurement policies from discriminating on the basis of where work would be performed. The threat of trade retaliation will make it more likely that courts ultimately will follow the 2000 U.S. Supreme Court ruling in *Crosby v. National Foreign Trade Council*, which found unconstitutional a state law that restricted Massachusetts agencies from purchasing goods and services from companies that do business with Burma.

THE ECONOMIC CASE AGAINST PROPOSED RESTRICTIONS

Douglas Irwin, an economics professor at Dartmouth University, explains two aspects of trade's domestic impact often overlooked in the outsourcing debate. First, he points out, "Consumers will be provided with the services they demand, at lower prices. As many businesses themselves purchase services, their lower costs will result in savings that can be passed on to consumers."[7] When a state government saves money it liberates resources for education, job training, and tax relief.

In addition, Irwin notes that the United States is both a major importer and exporter of services. When U.S. firms import services from India or elsewhere those dollars will eventually come back to America either through purchases of U.S.-made goods and services or as foreign investment in the United States.[8]

Other economic analyses support Irwin's views. Offshore outsourcing "creates wealth for U.S. companies and consumers and therefore for the United States as a whole," concluded a 2003 report by the McKinsey Global Institute. "Offshoring" saves U.S. companies, on average, 58 cents for every dollar spent overseas, thereby increasing productivity, profitability and competitiveness.[9]

CONCLUSION

A state that restricts international trade in any manner risks sending a negative signal to international companies looking for a place to invest in the United States. "Not welcome" signs rarely attract business. There are better ways to expand economic opportunity, including lowering the tax, regulatory, and litigation burden on employers. While there may be political mileage in legislating against international trade in services, the cost to particular states and America is not worth the price.

APPENDIX

2005: Summary List of States with Proposed Legislation Restricting Outsourcing

Alabama (health care data transfer restrictions)
Arizona (state contract ban on overseas work, call center restrictions)
California (requires disclosure of location of work on state contracts, in-state preference)
Colorado (state contract ban on overseas work, health care data transfer restrictions)
Connecticut (state contract ban, call center, personal data and health care info, restrictions, development assistance restriction for outsourcing companies, in-state preference, 90-day notice for transferring 25% of workforce)
Florida (call center and health care/data restrictions, report on location of state work)
Georgia (call center restrictions on state contracts)
Hawaii (state contract ban on overseas work, in-state hiring preference, development assistance restriction for outsourcing companies)
Idaho (state contract ban)
Illinois (health care data transfer restriction, call center restrictions)
Indiana (state contract ban on overseas work)
Iowa (state contract ban, call center restrictions)
Kansas (call center restrictions)
Maine (state contract ban on overseas work)
Maryland (state contract ban, trade agreement restriction)
Massachusetts (state contract ban)
Michigan (in-state preference)
Minnesota (state contract ban, data transfer and call center restrictions, reporting terminations)
Mississippi (state contract ban on overseas work, call center restrictions)
Missouri (state contract ban on overseas work, call center restrictions, in-state preference)
Montana (state contract ban on overseas work)
Nebraska (state contract ban on overseas work, health care data transfer restrictions, in-state preference)
New Hampshire (state contract ban, development assistance restriction for outsourcing companies, in-state preference)
New Jersey (state contract ban on overseas work, call center restrictions)
New Mexico (data restrictions)
New York (state contract ban, development assistance restriction for outsourcing companies, notification to workers of outsourcing)
North Carolina (disclosure if state contract work offshore)
North Dakota (state contract restriction, in-state preference)
Ohio (state contract ban on overseas work, outsourcing compensation fund for employees)
Oklahoma (state contract ban)
Oregon (state contract ban, call center restrictions, report, trade agreement restrictions)
Pennsylvania (no job transfers overseas without board approval, state contract ban, report)
Rhode Island (state contract ban)
South Carolina (in-state preference)
Texas (state contract ban on overseas work, health care data transfer restrictions)
Utah (in-state preference)
Virginia (state contract ban)
Washington (state contract ban)
West Virginia (call center restrictions, state contract and development assistance restriction for outsourcing companies)
Wisconsin (state contract ban)

Source: National Foundation for American Policy. *Note: A "state contract ban" refers to a bill that would prohibit work on state contracts to be performed overseas or by individuals not authorized to work in the U.S. Call center restrictions refer to bills that mandate operators identify their location in some manner. Health care and data transfer restrictions refer to bills that would either ban or require an "opt-in" for data to be processed outside of the U.S. Trade agreement restriction refers to mandate that a state not be party to international trade agreements on procurement.*

END NOTES

1 As of March 17, 2005 there were 112 bills in 40 states to restrict outsourcing in 2005. At the same date in 2004, there were 107 bills in 33 states. See Appendix for 2005 state list. Also, a link to a table tracking all 2005 bills can be found at the NFAP web site at www.nfap.com.

2 Copies of executive orders, legislative texts, and a re-cap of 2004 also can be found in the Global Sourcing Information section at www.nfap.com.

3 "Plug pulled on anti-offshoring bill, Sponsor promises to return with new proposal next year," *Rocky Mountain News*, March 16, 2005. "This year, the Colorado Department of Personnel & Administration calculated the bill would raise costs by $28 million to $73 million," according to the *Rocky Mountain News.*

4 Stuart Anderson, "Outsourcing Ban Ignores Constitution," Newark Star-Ledger, August 11, 2004.

5 Shannon Klinger and Lynn Sykes, *Exporting the Law: A Legal Analysis of State and Federal Outsourcing Legislation*, National Foundation for American Policy, April 2004. The study is available on NFAP's web site.

6 An excellent discussion of the "market participant" issue appears in Klinger and Sykes' *Exporting the Law.* The relevant portions, on pages 8 and 9, are excerpted below:

> Courts of Appeal disagree on the application of the market participant exception to the Foreign Commerce Clause. The Third Circuit has extended the exception to the Foreign Commerce Clause, upholding a Pennsylvania law requiring agencies of the Commonwealth, when undertaking public works construction projects, to include provisions in contracts that steel used in all projects be produced in the United States. The case is *Trojan Technologies, Inc. v. Commonwealth of Pennsylvania*, 916 F.2d 903 (3d Cir. 1990).
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> The First Circuit, on the other hand, declined to so extend the market participant doctrine: "Contrary to the Third Circuit's view in *Trojan Technologies*, we believe that the risks inherent in state regulation of foreign commerce – including the risk of retaliation against the nation as a whole and the weakening of the federal government's ability to speak with one voice in foreign affairs, weigh against extending the market participation exception to the Foreign Commerce Clause." (*Natsios*, 181 F.3d at 66 (citation omitted).
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> In sum, state laws that prohibit the performance of public contracts outside the United States may violate the Commerce Clause because they seek to regulate foreign commerce, an area of federal preeminence. Also, courts scrutinize state laws that affect foreign commerce, such as these, more strictly than laws affecting only domestic commerce. In addition, it is unsettled whether the market participant exception applies in the international context, further strengthening the case against the constitutionality under the Commerce Clause of state laws that prohibit the performance of public contracts outside the United States.

7 Douglas Irwin, *"Outsourcing" is Good for America*, American Enterprise Institute, January 29, 2004.

8 Ibid.

9 Martin N. Baily and Diana Farrell, "Exploding the Myths of Offshoring," *The McKinsey Quarterly*, July 2004.

ABOUT THE NATIONAL FOUNDATION FOR AMERICAN POLICY

Started in 2003, the National Foundation for American Policy (NFAP) is a 501(c)(3) non-profit, non-partisan public policy research organization based in Arlington, Va. The focus of the research is on trade, immigration, and other issues of national importance. NFAP Executive Director Stuart Anderson served as Staff Director of the Senate Immigration Subcommittee, working for Senators Spencer Abraham and Sam Brownback, and as head of policy and counselor to the Commissioner of the Immigration and Naturalization Service. The Advisory Board members include Columbia University economist Jagdish Bhagwati, Ohio University economist Richard Vedder, Rep. Guy Vander Jagt (ret.) and other prominent individuals.