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Outsourcing Saves Money

By Stuart Anderson

Within the first three months of 2005, more than 112 bills to restrict "outsourcing" already had been introduced in at least 40 states. That's more states and bills than last year at the same time. 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?

In 2004, only five anti-outsourcing bills became law and none 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.

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.

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.

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.

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.

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. 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.

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." 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.

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.

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.

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