Outsourcing of Services: Does It Lead to Job Losses?

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The international outsourcing of services has received a huge amount of attention in the media and political circles in recent months. Firms based in industrial countries that outsource services have been accused of "exporting jobs" to developing countries, with call centers and computing services in India the most frequently reported examples. Many people would argue that outsourcing has been a normal part of international trade for decades, and they would be right. What is tradable depends on technology, and advances in technology in information processing and communication, for example, are making it increasingly possible to trade services that previously were too costly to trade. Our research examines trends in outsourcing and whether it really means job losses.

How extensive is service outsourcing? All the media hype would lead one to believe that service outsourcing is exploding. But the data reveal that, although service outsourcing has been steadily increasing globally, it is still at very low levels in industrial countries like the United States. In its balance of payments statistics, the IMF reports imports of services, which include the categories that are most closely related to outsourcing—other business services and computing and information services. According to these statistics, U.S. business service imports as a share of GDP have roughly doubled in each of the past several decades, from 0.1 percent in 1983 to 0.2 percent in 1993 and 0.4 percent in 2003. In the United Kingdom, the share is about 1 percent of GDP; and in Italy about 1.7 percent of GDP. India, reported most prominently as a significant recipient of outsourcing, itself outsources a large amount of services. Its business services imports grew from 0.5 percent of GDP in 1983 to almost 2.5 percent of GDP in 2003.

Like trade in goods, trade in services is a two-way street. In addition to being a large importer of services, the United States is also a large exporter of services. The United States has a net surplus in all services, in contrast to its goods trade, in which it has a net deficit. In fact, the United Kingdom and the United States have the largest net surpluses in business services and hence would suffer the most in terms of the forgone dollar value of such trade if other countries cut service outsourcing. But this is not true of all industrial countries. For example, Italy, Germany and Ireland all have a net deficit in business services.

Are more jobs disappearing than are being created as a result of outsourcing? Our research, using the U.S. and the U.K. as case studies, show that overall, outsourcing does not lead to job losses. Rather, the results indicate that, when you look at finely disaggregated sectors, you find that only a small number of jobs are lost as a result of service outsourcing. For example, when disaggregating the U.S. economy to 450 industries there is a small negative effect on employment associated with service outsourcing. But aggregating up to 100 sectors, there were no job losses associated with service outsourcing. This implies that a worker could lose her job due to outsourcing but then she, or an unemployed worker, may find a job in another firm within the same industry. Hence, aggregated data would indicate that there are no net job losses when there is sufficient job creation, which indeed seems to be the case.

This is likely due to the positive boost that outsourcing gives to productivity. Our results show that increases in service outsourcing in U.S. manufacturing and services sectors go hand in hand with greater labor productivity. Why might this be? This is likely due to firms relocating their least efficient parts of production to cheaper destinations. For manufacturing firms, the largest category of outsourced services is, indeed, business services. Even if outsourcing lead to some shedding of labor, the increased efficiency could lead to higher production and an expansion of employment in other lines of work. For example, a firm might let some employees go because it imports its information technology services but then, as it becomes more efficient, it may decide to expand its research and development department, thereby creating new jobs.

Our results from the U.S and U.K studies suggest that service outsourcing not only would not induce a fall in aggregate employment, but also has the potential to make firms/sectors sufficiently more efficient, leading to enough job creation in the same broadly defined sectors to offset the lost jobs due to outsourcing.

Amiti, Mary, and Shang-Jin Wei, 2004, "Fear of Outsourcing: Is it Justified?" IMF Working Paper 04/186 (Washington: International Monetary Fund) and NBER Working Paper 10808 (Cambridge: National Bureau of Economic Research). http://www.nber.org/papers/w10808

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