



## Offshoring jobs: US and Australian debates

In 2004, several major Australian companies announced their decision to ‘offshore’ Australian jobs to India in an effort to cut costs. Telstra announced plans to move as many as 850 jobs to Indian software providers. It now spends up to \$150 million a year on Indian IT services. Optus and Hutchison Australia announced they would shift 150 and 200 jobs respectively to Indian call centres. The Commonwealth Bank and the National Australia Bank both investigated offshoring opportunities in India. This brief looks at the offshoring debate in Australia and the United States.

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## Executive Summary

This Research Brief looks at the issue of ‘offshoring’ in Australia and the United States. ‘Offshoring’ refers to a business decision to employ workers in another country to do the work once done by locals. It is a global expression of ‘outsourcing’, as companies in western nations are lured by significantly lower labour and other costs in the developing world.

Offshoring has been a feature of the modern global economy particularly since the 1970s, when rich country manufacturers began investing heavily in South East Asia and Latin America. The appeal and success of these ventures—more recently in China and Mexico—cost the jobs of many manufacturing workers in the western world. Western governments urged blue-collar workers into retraining and further education. Many believed that white-collar office jobs in the West were immune from low-wage foreign competitors. This has not been the case.

The development of digital information and communications technologies over the past decade has provided opportunities for companies to offshore clerical work and high-paying professional positions. The technologies, used by millions of expensive white-collar workers in the West, can be plugged in anywhere.<sup>1</sup> Telecommunications costs have fallen sharply. The prime targets of ‘services offshoring’, therefore, are jobs in computer programming, ‘back-office’ functions like billing and processing, and customer services such as call centre operations. Some companies are experimenting with offshored work in medical analysis, financial advice, editing, architectural services and even legal advice. India is the main destination for this work. It boasts a booming IT and business outsourcing sector, and an abundance of cheap and qualified, English-speaking labour.

This brief concentrates on the reaction to the loss of white-collar jobs in Australia and the US. The Australian debate responded to several major offshoring announcements, and the publication of research projecting Australian job losses. In 2004, Telstra announced that offshoring decisions by two of its multinational contractors—IBM and EDS—would transfer as many as 850 jobs to India; Optus announced plans to move 150 call centre jobs to India; and Qantas announced the transfer of 400 flight crew jobs to London by June 2005. In May 2004, a consultancy estimated that the Australian IT sector would lose 7000 jobs overseas in the next five years. However, a separate report released around the same time found only 12 per cent of 420 Australian IT firms surveyed had completed an offshore project. Research also identifies strong prospects for the Australian IT sector to develop as an offshore provider for North American and Western European companies.

The Howard Government and the Australian Labor Party have both emphasised the importance of promoting inward foreign investment in response to offshoring. Both reject any attempt to restrict companies from offshoring, although the Labor Party’s position is more guarded. It has flagged its opposition to offshoring government contracts, and has urged that companies be required to undertake a cost-benefit analysis prior to their decision to offshore. The Government sees offshoring as an inevitable part of a modern economy and is concerned to

help Australian industry and Australian workers adapt to the offshoring challenge. There is no proposed legislation dealing with offshoring at either federal or state level in Australia.

Offshoring services has proved far more popular in the US than among Australian companies. In the US, by contrast, the evidence of a 'jobless recovery' has made offshoring a topic of broad unrest. The American offshoring debate does offer some interesting points for comparison and contrast. In the absence of reliable official data, the US debate has also been fuelled by projections of the loss of jobs. The most reported estimate is that 3.3 million jobs will leave America by 2015. Another consultancy projects that 25 per cent of traditional American IT jobs will be offshored by 2010, including 10 per cent of all US technology jobs by the end of 2005. The evidence of a 'jobless recovery' in the US has made offshoring a topic of broad unrest. Growing insecurity among white-collar workers—and the loss of thousands of US manufacturing jobs since 2000—made offshoring a key issue in the 2004 presidential campaign. The Democratic National Platform promised to close tax loopholes for offshoring companies, provide tax cuts for companies that create jobs at home, curb outsourcing of government contracts, and propose a 'right to know' law that would force all call centres to disclose their location. The Bush administration continues to reject these measures by confirming its commitment to free trade. However, several American states have passed laws limiting offshoring of government contracts.

Trade economists have conducted their own offshoring debate. The question is whether the rapid transfer of jobs to developing nations erodes the traditional advantage of rich nations in value-added fields. Most economists argue that offshoring presents important benefits for rich economies. It adds to national output, lowers costs for local consumers and companies, and improves the competitiveness of local industry. All economists stress the need for governments to continue to invest in education, science and technology, and for workers to upgrade their skills and move into more sophisticated fields. However, some economists maintain that this alone is not enough. They argue that the seemingly inexhaustible supply of cheap foreign labour will erode the income of rich nations beyond what they can recoup through cheaper imports. Some fear that all jobs not requiring face-to-face contact are threatened.

Both the academic and the political debates on offshoring are structured by those who cite the positive, long-term impact of free trade on the economy overall, and those more concerned with the negative, short-term effect on specific sectors. This Brief notes some of the main policy recommendations from political parties, key interest groups and independent research organisations. They include economy-wide and sector-specific recommendations. Any public policy response must accept that cheap labour costs will lure many Australian companies and Australian-based multinationals overseas. The role of policy must be to set a framework to manage this flow, not to legislate against it. In particular, policy makers need to think strategically about developing a national skills base that is suited to the changing needs of the economy.

## Introduction

‘Offshoring’ refers to a business decision to employ workers in another country to do the work once done by locals. It is the global expression of ‘outsourcing’—where processes are performed by an organisation on behalf of a third-party supplier. Companies send jobs ‘offshore’ principally to save on labour costs. *The Economist* notes that ‘offshoring ... is dominated by US and British companies outsourcing their internal operations to third parties in places such as Ireland, Canada and South Africa, but most of all, India’.<sup>2</sup> It is estimated that a quarter of all business process outsourcing is now going offshore, and is growing at double-digit rates in the US and Europe.<sup>3</sup>

The benefits of offshoring for business are potentially significant. A 2003 consultancy report estimated that offshoring can save between 40 and 70 per cent in labour costs.<sup>4</sup> This is only partially offset by the additional technology, telecommunications and management overheads required to supervise overseas operations, which are estimated at 10 to 12 per cent. There are potential benefits beyond reduced wage costs. Developing countries offer a competitive and productive workforce, who value working for an overseas company. There are also advantages of scale, not only in terms of the ability to ‘throw more brainpower at a problem’, but also because many offshore providers are large-scale and well-established.<sup>5</sup> These conditions extend the range of economically viable services available to onshore companies.

Offshoring at this level is a business decision, but it is also of political concern. The American *National Journal* noted that offshoring ‘is acutely technical, and, above all, emotionally and politically charged’.<sup>6</sup> The loss of white-collar, service sector jobs was a major issue in the 2004 American presidential election campaign. It is an emerging issue in Australia following the announcement by major Australian companies—including Qantas and Telstra—that they intend to transfer work overseas.

This Research Brief is divided into seven parts:

- the first is a brief history of offshoring and its changing dynamic over time
- the second part looks at why offshoring of services is unique
- the third part examines the offshoring debate among economists
- the fourth part looks at the offshoring debate in America
- the fifth part presents research findings on the Australian experience with offshoring
- the sixth part analyses the Australian debate, and
- the final part looks at some of the policy recommendations from the main players in the debate.

## I. Three types of offshoring

Offshoring is not new, but its dynamic has changed over time. A distinction can be made between three types:

- ‘political offshoring’ refers to the exploitation of labour and resources during the centuries of European colonisation. For example, the British East India Company’s rule of India between 1757 and 1857 achieved political prestige for Britain, and a thriving trade for its empire
- ‘production offshoring’ refers to the free movement of capital to lower-wage offshore providers, particularly in the 1970s. The mobility of capital and the high productivity of newly industrialising countries—notably Korea, Taiwan, Hong Kong, Singapore, and more recently, China and Mexico—led to factory closures in the US and Western Europe, and
- ‘services offshoring’ refers to the loss of some white-collar, service sector jobs beginning in the mid-to-late 1990s, associated with the rapid transfer of information communications technologies to low-wage, offshore providers. The services commonly offshored include computer programming, ‘back-office’ functions like billing and processing, and customer services. The word ‘offshoring’ was coined in response to this recent phase.<sup>7</sup>

The use of offshore resources during the centuries of European colonisation is clearly different to their use by western nations in the competitive global economy of the past 30 years. The key difference is the rise in the power and ability of companies—rather than nations—to shift work to low-cost providers.

During colonisation, nations were the ‘offshorers’ and business took the opportunities that flowed. The company, worker and government of the ‘onshore’ nation all benefited, often to the detriment of ‘offshore’ peoples. The colonies’ labour and natural resources were exploited in the pursuit of national wealth and geopolitical advantage. Imports from the colonies fuelled Europe’s process of industrialisation. In a highly unequal international framework, wealth was funnelled from the colonised to the coloniser.

Since the 1970s, corporations have been the offshorers and governments are left to judge the impact of this on the national interest. Intermittently, the corporate tendency to produce abroad rather than to export has fuelled fears of ‘deindustrialisation’ in developed countries.<sup>8</sup> The loss of local jobs has led governments to encourage local firms to diversify their production and retrain their workers. There have been corresponding concerns that offshoring exploits developing countries. Still, it is widely accepted that the winners from offshoring cut across national lines. They include cheaper costs for the corporation, lower prices for consumers, and employment for the offshore contractor and its workers. In the increasingly integrated world of the 2000s, these trends have reached the provision of some services as technology transfers to low-cost, offshore suppliers.

## II. Why is services offshoring significant?

Is services offshoring simply an extension of production offshoring, or is it a fundamentally different trend? Several factors suggest continuity. First, the rationale is the same for both. Lael Brainard of the Brookings Institution (an independent US research organisation) explains that services offshoring is ‘a logical continuation of what we’ve seen in manufacturing’:

There is a relentless pressure in a market economy to drive down costs; to take any part of your production process that you can de-link that is not absolutely central to your corporate core value and move it to the cheapest provider, the cheapest location.<sup>9</sup>

Second, services and production offshoring are linked logistically. Offshored production often depends on the ability to offshore supporting services. The loss of manufacturing jobs overseas is accompanied by lost jobs in supporting services. The Institute of International Economics (US) has noted that the vast majority of offshored service jobs in the United States between 2000 and 2002 reflect the continuing loss of jobs in the manufacturing sector.<sup>10</sup>

Third, the economists’ debate on services offshoring is in some respects an extension of the arguments presented on production offshoring. The movement of service jobs overseas has reignited arguments among economists on the limits of free trade. The opponents of offshoring have questioned the relevance of British economist, David Ricardo’s famous concept of comparative advantage—that a country is better off if it specialises in what it is most efficient at producing, and then trades with other nations to obtain whatever other goods and services its citizens might want.<sup>11</sup> The defenders of offshoring and free trade argue that foreign competition in services ‘raises no new issues of principle whatever’.<sup>12</sup> Cheaper offshore service providers redeploy resources more advantageously, with added investment and growth in the exporting country and lower prices in the importing country.<sup>13</sup> They argue that the challenge for rich nations’ blue-collar and white-collar workers is to move into higher value-added industries. This process generated new employment in the manufacturing sector, and ‘there is no reason ... that the same shouldn’t happen with white-collar jobs’.<sup>14</sup> The economists’ debate is discussed in Part III.

### White-collar jobs were meant to be safe

The uniqueness of services offshoring is in who it affects. White-collar workers in developed countries were not meant to be vulnerable to overseas competitors. Governments and economists have argued that the highest value-added jobs will remain in developed nations because they are filled by the best-educated. The value-added jobs have been in financial services, telecommunications and computing, the growth areas of the 1990s. The loss of manufacturing jobs, while regrettable, encouraged an educated and innovative workforce, rather than a return to protectionism. However, new technologies, and an increasingly educated workforce, have made poorer nations highly competitive in a range of value-added

industries, including software engineering and financial services. Public Citizen, an American consumer rights group, noted:

... corporations increasingly are shipping out the very kinds of white-collar jobs in which the United States theoretically should have a competitive advantage and that were supposed to replace offshored manufacturing jobs.<sup>15</sup>

Herein lies a dilemma. For the reasons cited, services offshoring is a logical extension of trends in manufacturing. In terms of the mindset of developed nations, however, it is unexpected. It challenges the view of governments and professionals that well-paying, white-collar jobs will remain at home. It also challenges the basic assumptions that underpin this position. Australian journalist, Deirdre Macken, wrote in the *Australian Financial Review*:

Those of us sitting in front of screens in first-world offices thought the job-sharing contract meant that we did the high-paying, pleasant jobs of the knowledge era and the third world did the low-paying, dirty jobs of the industrial era ... Anyone who works with computers or technology is now on tenuous links with the workforce.<sup>16</sup>

Ron Blackwell, corporate affairs manager with the American Federation of Labor, sees services offshoring as a source of anger and disillusionment:

... if you work with your hands, of course you could lose your job, but, if you get an education, you'll keep your job. Well, many people did go and get an education and they're especially bitter about this trend for that reason.<sup>17</sup>

If some high-paying, professional positions can go offshore, is any job safe? Macken identifies several vulnerable occupations, from 'book-keeping, data input and all those jobs that were outsourced in the 1990s', to professional jobs including 'medical analysis, financial advice, editing, architectural services, legal advice of an international flavour and even public service'.<sup>18</sup> Others' predictions are more wholesale:

... the United States may be entering a new economic era in which American workers will face direct global competition at almost every job level—from the mechanist to the software engineer to the Wall Street analyst. Any worker whose job does not require daily face-to-face interaction is now in jeopardy of being replaced by a lower-paid, equally skilled worker thousands of miles away.<sup>19</sup>

This proposition is increasingly common, but it probably overstates the danger of services offshoring. Many factors other than cheap labour weigh on a company's decision to offshore, including operational, legal and cultural issues.<sup>20</sup> For example, the insurance firm, Consec, was forced to return 800 jobs from India to the US following concerns about the declining quality of work. Coles Myer was forced to return some of its credit card operations from India to Australia following customer complaints (see Table 4). These problems are discussed in Part V.

Table 1. The appeal of offshoring

	Labour costs per hour (US\$)	Average annual salaries of computer programmers (US\$)	Predicted average annual salaries of computer programmers 2015 (US\$)	Current account balance (per cent GDP)	Population	Median age (years)
India	.74	6 350	20 000	+5.0	1.06b	24.4
China	.80	5 850	10 000	+2.86	1.3b	31.8
Malaysia	2.19	6 950	9 000	+12.50	23.5m	23.8
Australia	19.45	38 600	45 000	-6.30	19.9m	36.3
Britain	19.24	*69 748	-	-1.60	60.3m	38.7
US	21.83	74 500	85 000	-4.90	293m	36

Source: 'Labour costs per hour' are taken from *The Economist*, 'Country Briefings', available at: <http://www.economist.com/countries/>; and 'Annual average salaries of computer programmers' taken from Whitehorse Strategic Group Ltd., Table 3, *Study of ICT Outsourcing and offshoring in Australia*, p. 20. \* Source: National Statistics (UK), *2004 Annual Survey of Hours and Earnings (ASHE)*, at [http://www.statistics.gov.uk/downloads/theme\\_labour/ASHE\\_2004\\_exc/tab4\\_7a.xls](http://www.statistics.gov.uk/downloads/theme_labour/ASHE_2004_exc/tab4_7a.xls) 'Population' and 'median age' figures taken from the CIA World Factbook.

Nonetheless, the general trend to offshore some services is unmistakable. Offshoring is motivated principally by low, per unit, labour costs. This alone, however, inadequately explains the attraction of certain nations for offshored services. Several underlying conditions are also necessary:

- first, political stability and economic liberalisation in the developing world has enabled technology and capital to flow more freely. India's economic reforms, beginning in the early 1990s, were crucial to enabling and attracting foreign investment
- second, the developing world is producing millions of highly motivated graduates 'who are as capable as the most highly educated workers in the developed world but available to work at a tiny fraction of the cost' (see Table 1).<sup>21</sup> Although higher education in developing nations is leavening the competitive advantage of the US, Britain and Australia, services offshoring will often favour English-speaking nations. India and Singapore are likely to benefit over China and Malaysia
- third, the developing world is young. Table 1 shows that the median age in India is 24 years; in the US, the UK and Australia, it is between 36 and 38. Fifty-four percent of Indians—555 million people—are under the age of 25.<sup>22</sup> The labour supply for offshoring companies is also highly motivated. The magazine, *Outlook India*, refers to 'zippies'; 'young city or suburban resident[s], between 15 and 25 years of age, with a zip in their stride ... oozes attitude, ambition and aspiration',<sup>23</sup> and

- fourth, the technology itself expands opportunities for services offshoring. The digitisation of information through the Internet and higher telecommunications bandwidth capacity allow companies to organise work so it can be centralised far from the customer.<sup>24</sup> Production offshoring, by contrast, has become more regionalised so that firms can be closer to customers and can benefit from regional free trade arrangements.<sup>25</sup> Many US manufacturing firms have shifted their offshore operations to closer locations, particularly Mexico.

### The importance of digitisation

It is facile to blame digitisation for offshoring, but crucial to recognise its importance. In simple terms, digitisation refers to the binary code of 0s and 1s that make up computer chips and enable sights and sounds to be sent instantly, anywhere in the world. The sophistication of this code has developed rapidly over the past 20 years. *New York Times* journalist, Thomas Friedman, refers to the ‘democratisation of information’ and technology. More information can be sent with greater speed and accuracy, and more people can access this information through satellites, phone lines and fibre-optic cables. Digitisation enables ‘all kinds of previously disconnected people the chance to access and apply knowledge’.<sup>26</sup>

Developing countries are increasingly dependent on digital technology to run their state services. From this base, technologies present corporate and employment opportunities. In the Indian state of Andhra Pradesh, notably, the government expressly took advantage of the inshoring opportunities enabled by digital technology. Priority is given to land for laying fibre optic cable, and a diesel generator ensures the power supply.<sup>27</sup> The state has become an example for other regions that are keen to connect with first world IT investment opportunities.

For developed countries, there is an emerging paradox. Digitisation has created unprecedented opportunities for creating wealth and employment. It has created new industries, such as software engineering; it has transformed existing industries, such as finance; and it has supported the efficiency and efficacy of several sectors, from public administration to publishing. However, it also enables the developed world to catch up technologically, and thereby present as an immediate option for outsourced work. Offshoring a manufacturing plant might take several months—even years—to identify an appropriate site, employ suitably qualified people and establish operations consistent with home-company requirements. Conversely, the decision to offshore a business process can be made and implemented within hours. The parts of the process can be divided and sent to the lowest cost locations worldwide. The result is that firms are more receptive and adaptable to change, but some service workers are more vulnerable to sudden retrenchment. As Jeffrey Garten from Yale University observes of services offshoring:

The reason I don’t think we’ve been through this before is that we’ve never had the ability for knowledge to be transferred so quickly. Now, the speed is very important, because it means that the normal adjustment process simply can’t take place in a socially acceptable or

politically meaningful time. So an entire process can be sent abroad, or sent around the world, almost overnight.<sup>28</sup>

As a result, one fault-line in the debate on services offshoring is the capacity of governments to retrain these workers, and labour markets to reemploy. Once jobs have left, some would agree that these workers should be compensated. However, the real debate is the acceptability of offshoring service jobs in the first place. Some commentators say it is regrettable, but necessary; others insist it is unacceptable.

### III. Is the theory of free trade wrong?

Services offshoring is causing a stir among trade economists. As mentioned, it contradicts the long-held belief that some white-collar jobs are immune from low-wage, foreign competition. This raises some challenging questions. Do the gains of the winners from offshoring really exceed the losses of the losers? Is offshoring compatible with the concept of ‘comparative advantage’, given the trade is in some services rather than goods? Does offshoring pose an exception to the free trade argument?

#### Do net benefits exceed net losses?

Many, if not most, economists reject any move to stop companies from shifting work overseas. Ricardo’s argument continues to hold, they argue, because in the long run, all nations will benefit. In any given nation, the gains of the winners from free trade will exceed the losses of the losers. Perhaps the most prominent defender of free trade in the offshoring debate is University of Columbia professor, Jagdish Bhagwati. Bhagwati insists that services offshoring adds to national output and the competitiveness of US companies—‘in a world economy, firms that forgo cheaper supplies of services are doomed to lose markets, and hence production’.<sup>29</sup> The *Australian Financial Review* concurs:

The critics all misconceive the way the global economy works and exaggerate the threat to white-collar workers. Individuals do lose jobs when production or services are sent to low-wage countries. But the economy benefits by acquiring those products and services more cheaply; people and firms previously unable to afford them can now do so; and the savings are spent or invested in more jobs and production.<sup>30</sup>

The problem with these arguments is that they are difficult to prove or disprove. The extent of the gains and losses from offshoring is uncertain. Even Bhagwati concedes: ‘... for the first time, high-skilled US workers are going to be exposed to international competition, though it’s not clear how much it will hurt their wages’.<sup>31</sup>

This uncertainty has allowed some economists to criticise offshoring. They question the consequences of offshoring for income distribution.<sup>32</sup> Nobel laureate, Paul Samuelson, recently presented this argument in the *Journal of Economic Perspectives*. Samuelson’s concern is that rising skill levels in China and India will have a greater adverse effect on mean US incomes and inequalities, than on the US economy at large through cheaper imports.<sup>33</sup> Others have supported the Samuelson thesis. Senior *BusinessWeek* writer, Aaron

Bernstein, claims that whereas production offshoring affected less than a quarter of the workforce, services offshoring could mean that a majority of the workforce lose more than they gain in lower prices.<sup>34</sup> Harvard University economist, Dani Rodrik, argues that 'it's entirely possible that all workers will lose and shareholders will gain; you have to be concerned about that'.<sup>35</sup> In similar vein, Nobel Prize winner, Joseph Stiglitz, comments:

... the problem with globalisation today is precisely that a few may benefit and a majority may be worse off, *unless government takes an active role in managing and shaping it*.<sup>36</sup>

### Do rich economies still have a 'comparative advantage'?

A closely related issue of contention among economists is whether the developed world can retain its comparative advantage in some hi-tech fields. For the offshoring pessimists, the cheapness and abundance of labour in poor nations negates rich nations' comparative advantage in some high-tech fields. In a competitive global economy, they argue, profit-driven companies will not let pass an opportunity to reduce costs drastically. Rich nations thereby lose their comparative advantage in some areas, and free trade enacts a highly unequal distribution of costs and benefits. Companies and shareholders gain; workers in these fields face lower wages and/or unemployment; and rich nations' export income is threatened as the new competition forces prices down.<sup>37</sup> The pessimists recite Bhagwati's 1968 comment that a country can be worse off if trade forces lower domestic prices for products in which it has a comparative advantage.<sup>38</sup> They cite services offshoring—a form of trade—as a prime example.

For some politicians and economists, offshoring demands a fundamental rethink of the free trade argument. US Democratic Senator, Charles Schumer, and former assistant secretary of the US Treasury, Paul Craig Roberts, argue that conventional theories of trade do not apply to offshoring. They contend that the benefits from comparative advantage only hold if capital and workers—the factors of production—are bound to the nation.<sup>39</sup> Schumer and Roberts insist they are not against free trade and reject protectionist measures. However, they do claim that offshoring violates the necessary conditions for mutually beneficial free trade.<sup>40</sup> In an article in the *New York Times*, they conclude: '... real and effective solutions will emerge only when economists and policymakers end the confusion between the free flow of goods and the free flow of factors of production'.<sup>41</sup>

George Reisman, a professor of economics based in Los Angeles, responded to Schumer and Roberts. His reply has three components. First, fears of mass US capital export are misplaced. Reisman argues that the majority of the capital invested in Asia is enabled by rapid increases in Asian production, not the export of US capital. Indeed, Asia is a potential net capital exporter to the US. Second, US real wages will not suffer from offshoring. Any reduction in Americans' money wages as a result of offshoring is 'always *less* than the reduction in costs achieved by the competitors', and less than the cost savings accruing to American consumers from cheap imports.<sup>42</sup> Third, Reisman argues that offshoring is part of an important process of promoting the economic development of the third world. This, he insists, is:

earnestly to be desired not only by the populations of those countries ... but no less by the populations of today's first-world countries. What would be achieved, along with the benefits of comparative advantage, is the maximum possible economies of scale in every branch of production, given the world's population. Above all, every branch of science, technology, invention and business innovation would be pursued by a far larger number of highly intelligent and motivated individuals than is now the case.<sup>43</sup>

Most economists would agree with Reisman. Overall, offshoring presents important benefits for rich economies, provided their governments continue to invest in education, science and technology. As noted earlier, the defenders of offshoring argue that the challenge for professional white-collar workers is the same as it was for manufacturing workers—'upgrade their skills, move into more sophisticated fields, and provide value for money'.<sup>44</sup> Some have argued that the pace of offshoring will make this transition manageable. For example, *The Economist* believes the process of offshoring will be gradual, enabling 'rich economies time to adjust to new patterns of work'.<sup>45</sup> Bhagwati argues that the attraction of cheap, skilled foreign labour for US companies is overstated. He sees that 'Americans' increasing dependence on an ever-widening array of technology will create a flood of high-paying jobs requiring hands-on technicians'.<sup>46</sup> However, this is not a common view, even among the defenders of offshoring. Edward Luce and Khozem Merchant argue that the size of the cost savings, the newness of (business process) offshoring, and improvements in service sector productivity, will ensure India remains a magnet for first world jobs.<sup>47</sup>

The academic debate will rage for some time yet. The arguments for and against will be refined as more is known about the extent and impact of offshoring. Services offshoring will not debunk conventional economic wisdom on free trade and comparative advantage. However, it has reignited debates among the economics profession on issues once considered settled. The trend of services offshoring may accentuate the division between economists interested in the long-term, net impact of free trade in a global economy, and those more concerned with the negative, short-term effect on specific sectors (see Table 2). As the rest of this brief shows, the same division is apparent in the political debate on offshoring, and the research that informs this debate.

Table 2. Economists' views on offshoring

	<b>Optimists</b>	<b>Pessimists</b>
Focus of concern	Consumers Long-term Economy-wide	Workers Short-term Specific sectors
Theoretical framework	Free trade Comparative advantage Upskilling	Some question the basis for free trade and comparative advantage given the mobility of labour and capital—very few support protection

Adapted from R. Atkinson, 'Understanding the offshoring challenge', *Progressive Policy Institute*, May 2004, p. 14.

#### IV. The US debate on offshoring

In the 2004 presidential election campaign, ‘jobs’ were a key domestic issue. Some polls rated the loss of jobs, particularly in manufacturing, as highly as national security.<sup>48</sup> The omens for President George W. Bush were seemingly not good, with Bush’s opponents presenting him as the first incumbent to preside over a net job loss since Herbert Hoover in the depression-era.<sup>49</sup> On one estimate, 1.6 million American private sector jobs were lost between 2000 and 2004, as well as 2.7 million manufacturing jobs.<sup>50</sup> The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) has referred to a ‘crisis in manufacturing’.<sup>51</sup> It notes that 48 American states have suffered job losses in manufacturing under President Bush. In large measure, the Federation blames cheap imports from China which reflected that nation’s repressive labour practices.<sup>52</sup> There was also publicity over white-collar job losses. In March 2004, a *New York Times* headline claimed: ‘No job is safe unless it’s at the nursing station’. Television presenters also railed against offshoring, one publishing a book blaming corporate greed for the export of jobs.<sup>53</sup> A national consumer advocacy organisation, Public Citizen, released a report the month before the election (held on to November 2004) claiming that the Bush administration’s policies ‘permit and promote’ the offshoring of jobs.<sup>54</sup> It noted that many of the major offshoring companies had contributed substantially to Bush presidential campaigns.

The US Democrats took advantage of this mounting publicity. Their campaign slogan—‘Strong at home, Respected in the world’—was reflected in a protectionist stance on offshoring. The Democrats’ presidential candidate, Senator John Kerry, promised tax changes to close a loophole for offshoring companies, tax cuts for companies that create jobs at home, curbs on outsourcing of government contracts, and a ‘right to know’ law that would force all call centres to disclose their location.<sup>55</sup> He also pledged tougher action against China’s labour practices through the World Trade Organization. President Bush rejected these measures, campaigning instead on the effect that major tax cuts would have in strengthening the economy and creating jobs. This message was particularly prominent following strong criticism of the President’s February 2004 report to Congress in which it was argued: ‘... when a good or service is produced at lower cost in another country, it makes sense to import it rather than to produce it domestically’.<sup>56</sup> The comments were seized on as evidence that the President supported offshoring.<sup>57</sup>

Two factors account for the rise of white-collar offshoring as a mainstream political issue in the US. The first is the poor health of the American economy. The cause of US job losses over the past four years probably has little to do with white-collar offshoring.<sup>58</sup> The Economic Policy Institute estimates that ‘it probably cannot account for more than 10% of the job gap of more than 5 million that has developed since the last recession began in March 2001’.<sup>59</sup> However, these job losses were significant. The IT professions that had sustained job growth over the 1990s were no longer insulated from the downturn, coinciding as it did with the end of the dot com boom. The unemployment rate of computer programmers was 7.7 per cent in March 2004; the national rate was 5.5 per cent.<sup>60</sup> Software manufacturers shed a higher proportion of jobs than in the manufacturing sector at large. It is likely that the

American IT sector suffered not only from general economic downturn, but also a correction within the sector following the large employment gains over the previous decade.

This raises a second factor. The anxiety caused by these large job losses is inflamed by the media's coverage of the projected number of jobs likely to be sent overseas. The debate on services offshoring in the US began in response to a 2002 study from the technology research company, Forrester. The study claimed that 3.3 million jobs would move offshore by 2015, including 500 000 in information technology.<sup>61</sup> There have been several predictions since:

- in April 2003, Deloitte estimated that as many as 15 per cent of financial services jobs (800 000) will be offshored by 2008<sup>62</sup>
- in May 2003, an A. T. Kearney survey of around 100 financial services firms found that 8 per cent of US financial services jobs—or more than 500 000 jobs—will be offshored by 2008<sup>63</sup>
- in March 2004, Deloitte estimated that 5 per cent (275 000) jobs would be offshored in the telecommunications industry by 2008
- the same month, research consultancy firm, Gartner, estimated that American IT companies will offshore 500 000 jobs in 2004 and 10 per cent of all US technology jobs by the end of 2005,<sup>64</sup> and
- Gartner also estimated that 25 per cent of traditional US information technology jobs will be located in developing countries by 2010.<sup>65</sup>

These projections obscure the fact that there is no reliable data on the total number of American jobs that have been sent abroad to date. There are no federal or state reporting requirements for jobs sent offshore, and companies rarely disclose this information. A September 2004 report by the United States Government Accountability Office was titled, 'Current government data provide limited insight into offshoring of services'. The data it did present suggests that services offshoring is not yet a major trend in America. For example, the report noted 2002 data on US investments in developing countries, which shows that the supply of offshore services was small compared to those in developed countries.<sup>66</sup> In 2002, services accounted for only 16 per cent of total US imports; these services imports accounted for just 3 per cent of US consumption of services.<sup>67</sup> The report also cited data from a US Department of Labor survey showing that layoffs attributable to overseas relocation—in companies with more than 50 employees—represent 0.9 per cent of total layoffs.<sup>68</sup> Data published by the Labor Department in June 2004 shows that offshoring accounted for only 2 per cent of the total number of jobs lost in the first three months of 2004.<sup>69</sup>

In the absence of official figures on offshoring, some groups have conducted their own surveys. The Communications Workers of America run a website titled 'Offshore Tracker'—<http://www.techsunite.org/offshore/>—which records from news accounts and employees the number of jobs offshored and the number of jobs lost. In the five years from 1 January 2000

to 1 January 2005, the site records that 303 794 jobs were offshored; 148 933 of these jobs were newly created positions; 154 861 were lost to another country. The site also lists the 'Top 10 culprits' of offshoring, which include General Electric, Accenture and Dell. The organisation notes that while its figures are understated, 'the tracker is the only source that accounts for and aggregates the number of jobs lost due to offshoring'.<sup>70</sup>

The defenders of offshoring have also publicised their findings. Business groups often cite a 2004 study by the McKinsey Institute. The McKinsey study found that every US dollar of corporate spending shifted offshore by a US firm to India generates US\$1.13 in new wealth for the US economy, and 33 cents for the recipient nation. The study also noted that:

- American firms' preference for Indian companies provides greater cost advantages than German firms' preference for East European nations<sup>71</sup>
- the American economy benefits from new revenues, with Indian companies purchasing US products in order to perform the offshored work, and
- offshoring promotes and confirms a dynamic American labour market, with 70 per cent of workers who lose jobs finding new work within six months.

The McKinsey report did insist that for all these benefits to the offshoring economy, 'the short-term pain of displacement must be addressed'. The 'targeted insurance products managed by businesses could ... help provide wages for those who lose jobs because of offshoring for an acceptable period of time'.<sup>72</sup>

### Attempts to ban offshoring government contracts

The acceptability of offshoring government work has been an issue of legislative contest in many US jurisdictions. Federally, President Bush passed a January 2004 law sponsored by Republican Senators, George Voinovich and Craig Thomas. The Voinovich-Thomas amendment limits government agencies from privatising or awarding certain new contracts to contractors performing work outside the US. Since then, several anti-offshoring bills have been introduced into Congress. The following four—all awaiting ratification at the time of writing—are the most significant:

- on 12 February 2004, Democrat Senator, Tom Daschle, introduced the Jobs for America Act in response to President Bush's Annual Economic Report (see above). It proposed an expansion of existing legislation to require companies that lay off 15 or more workers and send their jobs overseas to provide at least 90 days advance notice<sup>73</sup>
- in February 2004, Democrat Senator, Christopher Dodd, introduced the US Workers Protection Act 2004, which proposed a complete ban of offshoring privatised federal work, federal purchases of goods and services, and state government procurements.<sup>74</sup> The Act was passed by the US Senate in early March

- in March 2004, independent US Congressman, Bernard Sanders, introduced the Defending American Jobs Act. The Act requires government agencies to disclose the number of individuals employed in the US and overseas. Where a company is found to have laid-off a higher proportion of US workers than overseas workers, they would be prohibited from receiving federal assistance,<sup>75</sup> and
- also in March 2004, Democrat Senator, Hillary Clinton, introduced the Jumpstart Our Business Strength Act 2004, which aims to regulate the transmission of personally identifiable information to foreign subcontractors.<sup>76</sup> The amendment would require businesses to obtain prior consent from an existing or potential customer before their personal information is sent to a subcontractor.<sup>77</sup>

State legislatures have also initiated anti-offshoring laws. In July 2004, over 100 Bills were pending in 38 American states to curb the use of offshore contractors by state and local governments.<sup>78</sup> Several state governors have taken executive action to curtail the offshoring of state work:

- in 2003, the Governor of Indiana, Joseph Kernan, cancelled a US\$15.2 million contract to software company, Tata Consultancy Services, in India, after no Indiana firms bid for the job<sup>79</sup>
- in March 2004, the Governor of Missouri, Bob Holden, signed an executive order banning state agencies from awarding contracts to vendors who plan to perform the work outside the US<sup>80</sup>
- in April 2004, the Governor of Arizona, Janet Napolitano, issued a directive to the State Department of Administration to ban state work from being sent offshore,<sup>81</sup> and
- in May 2004, the Governor of Tennessee, Phil Bredesen, amended the state's procurement code, giving preference to data entry and call centre contractors that do not offshore.<sup>82</sup>

Not all state governors have opted for punitive measures. In August 2004, the Californian Senate passed a Bill banning state agencies from contracting services to companies that use overseas labour.<sup>83</sup> However, in October 2004, Californian Governor, Arnold Schwarzenegger, vetoed this and two other anti-offshoring bills that would have confined state agency contracts to US-based firms employing US workers. Governor Schwarzenegger claimed his decision was in the best interests of the recession-hit Californian economy, and that the wrong approach was to implement measures that restrict trade.<sup>84</sup> The Assembly Speaker, Fabian Nunez, replied that 'the people's tax dollars will continue to support jobs in India and Mexico'.<sup>85</sup>

## **V. Australian research on offshoring**

There have been five studies into the nature and extent of services offshoring in Australia. In 2003, the Australian Computer Society commissioned the consultancy, Whitehorse Strategic, to examine the impact of offshoring. The report, 'Study of ICT Outsourcing and Offshoring

in Australia' was published in May 2004. The same month, the Society received a report from Access Economics titled 'Economic perspectives on offshoring'. Also in May, the consultancy Booz Allen Hamilton, published 'The Trends and Implications of Offshoring for Australia'. In July 2004, the Business Council of Australia presented its policy position in 'Offshoring, Global Outsourcing and the Australian Economy'. Finally, in December 2004, the Australian Information Industry Association released the findings of a qualitative survey of IT managers titled 'Status of Offshore Outsourcing in Australia'. As explained in Part VI of this brief, these reports have been influential in the Australian debate on offshoring.

### **The Whitehorse report**

The Whitehorse study's main finding is that while the offshoring component of Australian IT outsourcing will grow for the next two years, it will not reach the high compound annual growth rates predicted by many industry analysts.<sup>86</sup> The report criticised the 'media hype' on offshoring, which it blamed on reporting the gross displacement of employment, rather than the net effect. The net effect of IT offshoring must weigh the value of services exports—services to clients outside Australia—against lost profits and exported jobs. On this basis, Whitehorse found that Australian IT service losses marginally exceeded revenues in 2003. The estimated 7000 IT jobs lost represents 2.3 per cent of total professional employment in the Australian IT sector.<sup>87</sup>

This message was somewhat confused, however, by the report's 'worst case scenario', which claimed that 11 000 IT jobs would go offshore in the next five years. Only 7000 jobs would be created by overseas IT work performed in Australia, leaving a net loss of 4000 jobs. Ironically, one newspaper article reported '11 000 jobs may go: ACS report'.<sup>88</sup> Still, most of the media coverage focussed on the report's conclusion that offshoring does not necessarily lead to overall economic gains. As explained in Part VI of this brief, the Australian Computer Society welcomed this caution.

### **The Access Economics report**

The report by Access Economics to the Computer Society recommends a more rigorous assessment of the costs and benefits of offshoring. The report welcomes opportunities for Australian IT firms to win overseas contracts, and for competitors to provide the domestic IT sector 'with healthy competition'.<sup>89</sup> Where IT jobs are lost, the freed resources will be put to more productive use, 'as Australia can import the equivalent service for less'.<sup>90</sup> However, it cautions that the lure of lower costs often leads business to offshore without proper consideration of the quality of service. Where a business has doubts about the reliability of an offshore supplier, it should recognise that 'a mistaken decision in favour of offshoring is likely to cost rather more to undo'.<sup>91</sup> The report argues that offshoring is a trap for businesses with structures that reward management for short-term cost savings, and ignore the long-term issues of quality and sustained benefits.

Access Economics also notes that a longer-term business perspective must acknowledge the effect of exchange rate volatility, which can either accentuate or reduce cost advantages.

Australian companies offshoring to India, for example, have benefited from an appreciation of the Australian dollar from 24.8 rupees in November 2001 to 34.7 rupees in November 2004.<sup>92</sup> The cost to Australian companies of paying Indian wages and establishing the necessary infrastructure in India has become cheaper. The value of the American dollar, on the other hand, fell from 48.04 rupees in November 2001 to 45.04 rupees in November 2004.<sup>93</sup> Access Economics notes that there are some measures to avoid exchange rate volatility in the short term, including a fixed price contract in Australian dollar terms with overseas suppliers. However, these arrangements must come up for renewal and offshoring companies may then be faced with unfavourable exchange rates and the prospect of reverting to an alternative supplier.<sup>94</sup> Accordingly, long and larger offshoring contracts are to be preferred.

### **The Booz Allen Hamilton report**

The Booz Allen Hamilton report is similarly circumspect about the business decision to offshore, but confident that the economy-wide impact of offshoring is positive. The report argues that the decision to offshore is 'not for every firm and certainly not for every business process'.<sup>95</sup> While lower costs are the main reason why companies offshore, there are other important considerations, including the quality and reliability of labour, the political environment, and technological infrastructure. The report does acknowledge the enthusiasm for offshoring within the business community and the potential benefits. It cites a Forrester Research survey of Australian and New Zealand companies which found that half the companies had either offshored already or intended to do so by the end of 2004. Its own research found possible gross cost savings from offshoring of 55 per cent, although technology, telecommunications and management overheads reduce this figure by 10 to 15 per cent.<sup>96</sup>

Nonetheless, the Booz Allen Hamilton report insists that the public outcry about offshoring is at odds with the reality that Australia is unlikely to lose a vast number of jobs. Its optimism is based on the facts:

- 73 per cent of Australia's labour force is employed in service industries that cannot be offshored
  - ABS figures for the August 2004 Quarter show employment in the non-traded sectors immune from offshoring include retail trade (1.408 million), cafes and restaurants (488 300) and health and community services (984 200 people)<sup>97</sup>
- 66 per cent of Australian workers are in businesses with less than 100 employees, which have fewer offshore opportunities because they are unable to achieve the scale benefits of large businesses, and
- the most rapid area of employment growth in Australia has been in these small to medium sized businesses.<sup>98</sup>

The report argues that the challenge is to accept ‘that offshoring will have a relatively low impact on total employment, but to manage those impacts and adjustments as well as possible’.<sup>99</sup> To this end, it warns that prohibiting companies and governments from offshoring would threaten Australia’s access to export markets and its attractiveness as an offshoring site. In the long term, the report accords a key role to the education system ‘to enable workers to ... upgrade their skills and move into more sophisticated fields’.<sup>100</sup>

### The Business Council’s report

Of the five offshoring research reports, the Business Council’s July 2004 position is the most optimistic. In general terms, it notes the resilience of the Australian economy to downturns in global economic activity and stock markets. Specifically, the Council emphasises Australia’s attractiveness as a destination for offshoring. It cites a 2004 KPMG study comparing business costs among 11 developed nations in which Australia ranked second overall (to Canada).<sup>101</sup> Australia had the lowest average property taxes and second lowest labour, utility, transportation and facility costs.<sup>102</sup> The Business Council underlines these findings with recent examples of major financial services companies establishing a base in Sydney and Melbourne. It notes that ‘a highly skilled workforce, stable political system and the relative quality of our infrastructure and regulatory environment’, offsets Australia’s high labour costs relative to developing countries.<sup>103</sup>

The Business Council shied away from estimating the impact of offshoring on Australian jobs. Instead, it notes findings on the resilience of, and potential gains to, the Australian economy:

- between 1988 and 1998, 2.5 jobs were created for every 1.5 jobs shed
- only 2 to 4 per cent of jobs in Australia could be offshored (see Booz Allen Hamilton, above)
- the US economy’s net gain of US\$1.14 from every dollar offshored (see McKinsey, above), and
- communications companies projected savings of at least \$20 billion annually by offshoring services to developing countries.<sup>104</sup>

The Business Council President, Hugh Morgan, explained that the report was intended to ‘demystify the demonisation of offshoring’.<sup>105</sup> Part VI notes media reaction to the Council’s report.

### The Australian Information Industry Association survey

The Australian Information Industry Association is the peak body of the Australian IT industry and represents over 420 member companies. In May 2004, the Association reported on its (April) survey of 100 Chief Information Officers and IT managers. It found that ‘12 per cent of [these] enterprises have already completed an offshore project while another five per cent are considering it as an option later this year’.<sup>106</sup> There was both ‘passionate resistance’

and ‘strong support’ for outsourcing IT projects. Eighty-two percent of respondents saw offshoring as a ‘threat to local employment’, 58 per cent saw it as a ‘long-term danger to industry development’, and 70 per cent disagreed that offshoring was ‘necessary with a lean budget’.<sup>107</sup> However, 50 per cent of respondents saw offshoring as offering a ‘world class service’, and 62 per cent believed it was the ‘best value for money’.<sup>108</sup>

In December 2004, the Association released a qualitative study, based partly on these survey results. A key finding is that Australian IT managers are pragmatic when it comes to offshoring. If the same quality of work can be achieved at a cheaper price offshore, then software companies will move their operations. The report notes that long-term hiring strategies in IT departments of leading Australian companies are being reviewed in light of offshoring opportunities. In general, Australian IT managers ‘do not feel they need to consider industry implications, such as loss of work to the Australian ICT industry and subsequent risk to local jobs’.<sup>109</sup>

However, the report notes that ‘the offshore model also has its opportunities for Australia’.<sup>110</sup> Operational costs for software development in Australia are 25 per cent lower than those in North America and Western Europe (also see Table 1). Many respondents noted that the quality of Australian software developers means Australia is an attractive market for higher value services, leaving the process-oriented programming to offshore suppliers such as India and Malaysia. The strategy for many IT managers, therefore, is to ‘ship offshore their so-called “code-cutting hackwork” and move their staff on to more strategic and valuable tasks for their organisation’.<sup>111</sup> Part III of this brief noted economists’ emphasis on ‘upskilling’ as a means for rich economies to retain their comparative advantage. In the case of the Australian IT sector, upskilling is a way to attract multinationals offering higher-value work.

Accordingly, the Association’s report urges the federal government to promote Australia’s software skills and consultancy expertise overseas. It argues the need for a national IT development strategy, which encourages local companies to focus on high-value software skills, sells these skills to prospective foreign investors, and markets the IT industry’s intellectual property. The following discussion notes that promoting inshoring is an important aspect of the Australian offshoring debate.

## **VI. The Australian debate on offshoring**

The debate on offshoring in Australia is relatively new. In the print media, one of the earliest discussions was in Deirdre Macken’s July 2003 article. She noted:

Offshoring is an expression creeping into conversations downtown and while it sounds like nautical ambitions on a lazy Saturday afternoon, no one is feeling light and breezy about this term.<sup>112</sup>

There has been a marked increase in the use of the term in the Australian media. Still, the Australian debate on offshoring is new compared with the American debate. During the Australian election campaign—29 August to 9 October 2004—the major Australian newspapers mentioned offshoring in only 22 articles. In the US election campaign, the loss of

jobs and the culprit of offshoring was a key issue. Notably, the US media associates offshoring far more with the loss of manufacturing jobs in traditional, blue-collar industries than the Australian media.<sup>113</sup>

The relative health of the US and Australian economies is significant. With the Australian unemployment rate at its lowest level since 1977, it is unsurprising that offshoring is not an issue of key concern. In the US, by contrast, the evidence of a 'jobless recovery' has made offshoring a topic of broad unrest. As Joseph Stiglitz puts it, '... were unemployment lower, the worries about outsourcing would be less'.<sup>114</sup> Survey data supports this. An international survey conducted in November 2004 found 26.3 per cent of Australians believed 'it would be easy for a person to find a similar job'.<sup>115</sup> Only 18.2 per cent of US respondents were as confident.

### Which Australian companies have offshored?

Table 3 lists the major offshoring decisions by Australian companies until December 2004. It shows that India is the main destination for offshored work, beginning in 1989 with the establishment of ANZ's software operation near Bangalore.<sup>116</sup>

Most of the offshoring activity has taken place over the past two or three years. AXA Asia Pacific announced in early 2002 its decision to relocate some of its wealth management division to India.<sup>117</sup> The company had consulted the Federal Treasurer, the Hon. Peter Costello, before making its decision. AXA gained further publicity in November 2004 following its decision to outsource work to the Indian software company Wipro. *The Australian* reported that 40 Australian jobs would be lost, 20 of these moving to Bangalore.<sup>118</sup> An AXA spokesperson claimed local Australian suppliers had not responded to the contract opportunity.

In 2003, Hewlett Packard and Hutchison Communications both announced their decision to shift work to India. Hutchison now has the majority of its Australian call centre operations in India.<sup>119</sup> Coles Myer shifted its credit card processing operations from Melbourne to Delhi in 1999. In July 2003, however, the company relocated back to Melbourne.<sup>120</sup> The Australian Services Union claimed the decision to return followed a consumer backlash and the airing of an ABC television documentary, 'Diverted to Delhi', which explained how Indian staff were trained in call centres.<sup>121</sup> Coles Myer did retain an overflow facility in India for when credit card volumes exceed a certain level.

Table 3. Examples of major Australian companies sending work offshore

<b>Company</b>	<b>Date of announcement</b>	<b>Decision</b>
<b>ANZ</b>	Operation established in 1989	ANZ IT established in Bangalore employing 400 software programmers. As at January 2005, 530 were employed.
<b>Coles Myer</b>	1999	Shed 150 jobs moving its credit card processing operations to India.
<b>Qantas</b>	April 1999	Announced a recruiting base in Thailand because of the need for a more ethnically diverse cabin crew.
<b>AXA</b>	Announced: February 2002 Confirmed: November 2004	65 IT jobs moved to India over the next 15 months (from October 2002).
<b>NAB</b>	2001 and 2002	Engaged Tata Consultancy Services.
<b>Hewlett Packard</b>	2003	Transferred its Asia-Pacific call centre support services to Bangalore, leading to the loss of 128 Australian jobs.
<b>Hutchison Telecommunications</b>	2003	Moved 200 customer retention and business support group jobs to Mumbai.
<b>Coles Myer/ GE Consumer Finance</b>	July 2003	Jobs returned from Delhi to Melbourne, but with an overflow facility in India for when credit card call volumes exceed a certain level.
<b>Telstra/Infosys</b>	September 2003	180 jobs lost in Infosys relocation of Telstra contract to India.
<b>Telstra/IBM</b>	January 2004	Telstra shifted 450 IT jobs from its contract with IBM Australia to IBM's global operations in India.
<b>Qantas</b>	June 2004	Will locate 400 flight attendant jobs to London by June 2005 to save on accommodation costs.
<b>Commonwealth Bank</b>	September 2004	Appointed an outsourcing expert to open its first office in India.
<b>Telstra/EDS</b>	October 2004	Telstra's contract with EDS Australia renewed in return for transferring 400 jobs to India over the next 15 months.
<b>Optus</b>	November 2004	150 call centre jobs moved from Devonport, Tasmania, to India.
<b>Westpac</b>	January 2005	Tata used for a software development project.

Sources: *Australian Financial Review*, 30 April 2004, p. 80; 'Axa moves back office to India', *Australian Financial Review*, 6 February 2002; 'Optus moves 150 jobs from Tasmania to India', *The Australian*, 19 November 2004, p. 20; 'Qantas to relocate 400 crew overseas', *Sydney Morning Herald*, 23 June 2004, p. 4; S. Dabkowski, 'Time for a rethink on India: report', *The Age*, 4 December 2001; M. Maiden, 'National ponders passage to India', *The Age*, 29 November 2004, p. 12; P. Robinson, '400 jobs head for India', *The Age*, 20 October 2004, p. 3; and J. Riley, '50,000 bank jobs may go to India', *The Australian*, 18 January 2005, p. 27.

Qantas has had two major experiments with offshoring. In April 1999, the company announced it would establish a recruiting base in Thailand because of the need for a more ethnically diverse cabin crew. The Flight Attendants Association argued that this ignored the ethnic diversity of the Australian crew.<sup>122</sup> The Association viewed the decision as a cost-cutting exercise given the relative cheapness of Thai wages. In June 2004, Qantas announced its decision to relocate 400 flight attendants to London by the middle of 2005. In this case, the choice of relocation was not to capitalise on lower per unit labour costs, but to save through changes in rostering and accommodation and allowance costs. Qantas anticipates savings of \$18 million annually.<sup>123</sup> It insists that Australian cabin crew will be given priority for the London positions, on contracts of up to three years. Qantas noted strong local interest for the jobs, which would be at a higher pay than comparative Australian wages but would involve longer hours. A *Sydney Morning Herald* editorial commented on the Qantas decision: 'moving more jobs offshore is inevitable, and is to be embraced as long as it does not compromise safety, because it ensures the company's long-term viability'.<sup>124</sup> In January 2005, Qantas chief executive, Geoff Dixon, announced that the airline had no choice but to source more of its people, services and products overseas in order to remain competitive.<sup>125</sup> Singapore Airlines and Cathay Pacific consistently source 30 per cent of their products and services from other countries; Qantas currently employs 94 per cent of its 35 000 staff in Australia.<sup>126</sup> A target of 30 per cent would mean the loss of 8400 Australian-based Qantas jobs.

Telstra is Australia's most prolific offshoring company. In September 2003, the company pledged to reduce its \$1.5 billion IT operations bill to \$750 million.<sup>127</sup> It flagged a review of arrangements with the 200 companies which supply Telstra with goods and services. Some sources estimated that as many as 1500 Australian jobs would be offshored.<sup>128</sup> Telstra's contractors have made four major offshoring decisions:

- the first, in September 2003, was a five year, \$75 million contract with Indian company, Infosys, which Telstra itself estimated could cost up to 180 Australian jobs.<sup>129</sup> The Infosys contract cost IBM of some of its core business with Telstra
- the second was an announcement in January 2004 that 450 software programming jobs would go to India. The *Australian Financial Review* described it as 'the biggest example yet of sending skilled Australian jobs to low-wage countries'.<sup>130</sup> Telstra explained it was simply extending its contract with IBM, and that the US-based, IBM Global Services had chosen to send the work to its service operations in India
- the third decision, announced the following week, was to establish a Telstra unit with the Bangalore-based, Satyam Computer Services. An article in *The Australian* estimated that 'almost 800 jobs involved with Telstra's IT contracts may now move to India'.<sup>131</sup> Although the contract was confirmed in September, the extent of Australian job losses remains uncertain, and
- the most recent announcement was in October 2004. Telstra negotiated a five-year, \$100 million contract with US company, EDS, to manage its landline billing systems.

Four hundred, Melbourne-based jobs will move to an EDS 'solution centre' in India over 2005.

Optus, Telstra's competitor, has also gained headlines for an offshoring decision. In November 2004, the company announced plans to cancel the contract of a Sitel-run call centre in Devonport and relocate to India. The decision threatens up to 360 Tasmanian jobs.<sup>132</sup> The call centre operation is currently seeking alternative customers to make up for the lost business.

This chronology shows there is no set pattern to the offshoring decisions made in Australia. In some cases, Australian companies themselves seek an offshore contractor (Optus, Telstra and InfoSys). In other cases, an Australian company may give a contract to a locally-based foreign contractor, which then decides to employ its own overseas staff (Telstra and IBM). Employment arrangements may also vary. The Australian company may make the employment of overseas workers a condition of the contract (Telstra and EDS), or it may give Australians priority for overseas work (Qantas). The desire to decrease costs is common to all offshoring decisions, whether by the contracting company or the contractor. Still, political factors sometimes intervene (Coles Myer).<sup>133</sup>

#### **A key player in the Australian debate**

The Australian Computer Society has been highly influential in shaping opposition to the loss of Australian IT jobs. As early as December 2003, the outgoing National President, Richard Hogg, warned that offshoring was depleting the national, IT skills base.<sup>134</sup> Hogg noted the anomaly of an IT skills shortage at the same time as high unemployment in the IT sector. He also questioned the benefits of offshoring, given recent examples 'where cultural differences, poor project management, testing and integration issues have resulted in less than satisfactory systems'.<sup>135</sup>

In May 2004, the Society released its 'Policy Statement on Offshoring' based on the Access Economics and Whitehorse Strategic reports. The statement contains two broad recommendations. First, it urges the Government to collaborate with the local IT industry to promote Australia as an offshoring destination. Accordingly, the Society suggests the creation of an agency dedicated to promote Australia's IT abilities, and the development of industry policies which enhance these capacities. The Society supports free trade and the benefits that flow from imported work and increasing the competitiveness of the local IT sector. However, it also stresses the need for wider access to training schemes, saying 'we have an obligation to create a soft landing to ensure that those made redundant are offered the opportunity for reskilling'.<sup>136</sup> Second, the Society argues that companies considering offshoring should use a cost-benefit checklist to ensure that offshoring is done 'for the right reasons'.<sup>137</sup> It urged the Government to endorse publicly the use of this checklist for major companies, and to devise a similar list for Commonwealth departments. The potential costs and benefits of offshoring are presented in Table 4.

Table 4. The ACS offshoring cost-benefit checklist

<b>Cost</b>	<b>Benefit</b>
Overstated cost savings	Cost reductions
Risking intellectual property	Increased competitiveness
Language and cultural barriers	Spreading of risk
Regulatory compliance	Cross border partnerships
Difficulty repatriating profits	New market penetration
Complexity in legal obligations	Alleviate worker shortages
Security concerns—geopolitical	Greater productivity and flexibility
Difficult to manage a global team	Leverage external economies of scale

Source: Australian Computer Society, ‘Policy Statement on Offshoring’, pp. 4-5.

The Access Economics report was clearly influential in the Society’s statement. Apart from endorsing the cost-benefit checklist and support for free trade, the Statement also includes cautions on service quality, exchange rates and the cost of a wrong decision. The Australian Computer Society has, in turn, been influential in the party debate on offshoring in Australia.

### The positions of the major political parties in Australia

The major political parties in Australia have adopted contrasting positions on offshoring, although the differences have narrowed after the 2004 federal election. The Howard Government rejects any attempt to ban offshoring, but has an obvious preference for work to remain in Australia. Following Telstra’s January 2004 decision, for example, the Treasurer commented:

I think that wherever possible, those jobs ought to be located in Australia ... They [Telstra] have to have a very good reason to show that they can’t find adequate Australian employment opportunities and Australians to fill them.<sup>138</sup>

However, the then Minister for Communications, Information Technology and the Arts, the Hon. Daryl Williams, rejected suggestions that the government—Telstra’s majority shareholder—should intervene. Offshoring is a business decision, he argued, and should properly be left to the company board.<sup>139</sup> The Minister welcomed the release of the Information Industry Association’s April 2004 survey, noting that Australian organisations ‘appeared loyal to local suppliers’.<sup>140</sup> He also highlighted the government’s support for the Association’s emphasis on assisting the local IT industry, particularly through its assistance for innovative IT start-up companies.<sup>141</sup> The government’s prime response to offshoring is to encourage foreign investment in Australia’s IT industry through agencies such as Invest Australia.<sup>142</sup> Its strategic plan for the Australian IT sector—*Connecting an Innovative*

*Australia*—notes the imperative of onshore opportunities, but makes no mention of the impact of offshoring. This has led the Labor Party to argue that the government ‘promotes offshoring’,<sup>143</sup>

The Labor Party’s position on offshoring has since been more cautious. In early 2004, the Party’s National Conference expressed ‘concern at the recent trend in outsourcing information technology and call centre functions to off-shore providers’. In March 2004, Lindsay Tanner, the then Shadow Minister for Communications, shared a stage with the President of the Australian Council of Trade Unions (ACTU) to protest Telstra’s offshoring decision.<sup>144</sup> Mr Tanner explained that as Minister, he would notify the Telstra board that it contravened its responsibilities to the Australian community. In May 2004, Senator Kate Lundy, the Shadow Minister for Information Technology and Sport, called on the government to endorse the Computer Society’s cost-benefit checklist. Senator Lundy argued that the checklist would demonstrate that both public and private sector IT services ‘can be efficiently and effectively provided within Australia’.<sup>145</sup> In August, she argued that ‘where Australia can compete, the work should stay onshore’.<sup>146</sup> The Government labelled the Labor Party’s stance ‘protectionist’. Earlier in the year, Daryl Williams suggested that Labor was captive to the demands of the union movement, which had supported US-style legislation penalising companies that engage in offshoring.<sup>147</sup> He argued, ‘unlike Labor or the unions, the government does not pretend that globalisation can be stopped’.<sup>148</sup>

However, following Labor’s loss in the October 2004 federal election, the new Shadow Minister for Communications and Information Technology, Senator Stephen Conroy, publicly opposed protectionist measures. He argued:

... in my view any form of protectionism is not a viable response ... Labor has always understood ... that the process of globalisation creates winners and losers ... The reality is that off-shoring is likely to grow in some areas and will displace people currently employed in the (IT) industry.<sup>149</sup>

Senator Conroy prioritised efforts to develop the right IT skills to attract jobs in areas where Australia has a ‘competitive edge’. He broached the idea of a stand alone agency responsible for promoting the Australian IT sector, and a dedicated ICT mission in India. The speech reaffirmed support for Senator Lundy’s recommendations—companies should subject offshoring decisions to a ‘rigorous cost-benefit analysis’, and government should assist with reskilling displaced workers. However, Senator Conroy’s comments were criticised by the union movement for the lack of protection and compensation for workers. The ACTU claimed that Labor’s stance in January 2004 had been more interventionist. Labor’s spokesman for Trade, the Hon. Simon Crean, insisted that the Party’s position was ‘entirely consistent’, affirming its reputation as the party of free trade.<sup>150</sup> This may be, although it now seems unlikely that Labor will publicly campaign with the unions to protest future offshoring decisions.

## VII. Some policy options mentioned in these debates

The above discussion on the US and Australian debates has mentioned some possible policy options for an Australian government in responding to offshoring by private sector companies and government agencies. This Part lists some of these recommendations from political parties, key interest groups and independent research organisations. The intent is to recognise these options, not to favour or prescribe a particular course of action.

The options can be divided between those that offer an economy-wide response to offshoring, and those that are specific to the IT sector. The economy-wide options are to:

- *promote fair and free trade.* There is general consensus in Australia that any attempt to stop offshoring will hurt the profitability of the offshoring company, which will often have many more resources employed locally. It will hurt domestic consumers by keeping prices artificially high. It might also lead to retaliatory action, limiting Australia's access to markets and investment opportunities. The benefits of a 'free trade' policy are local reinvestment of profits, consumer savings, and an inducement for greater innovation and competitiveness among local companies
- *continue promoting inward investment through free trade agreements.* The recent Australia-US Free Trade Agreement (AUSFTA) exemplifies this approach. The US is Australia's largest foreign investor with AUD\$71 billion, or nearly 30 per cent of total foreign investment. In industries such as film, the projected employment gains from inshoring US companies are significant. The Whitehorse report noted that 'opportunities exist to provide specialist functional skills and services in support of multinational corporations'.<sup>151</sup> These services include high-end software research and development, technical support services, and systems design and architecture
- *continue promoting the Australian economy and its workers by actively selling investment opportunities.* This is also current government policy. Invest Australia is the agency currently responsible for promoting foreign investment in Australia, largely through public relations. Its web site lists '10 good reasons to invest in Australia': strong economical credentials; democratic and politically stable; highly skilled and multilingual workforce; dynamic financial services; sophisticated telecommunications and Information Technology Systems; innovative culture with excellent research and development infrastructure; cost competitive location; open and efficient regulatory environment; strategic time zone; welcoming attitude and excellent quality of life<sup>152</sup>
- *focus on education and training, research and development.* All the major players in the Australian offshoring debate emphasise the importance of improving the nation's research and skills base. Comparative advantage lies in technological innovation and a higher skilled, more productive workforce
- *collect better data on the number of jobs offshored.* Parts IV and V of this Brief found an inadequate scheme of data collection on offshoring in both the US and Australia. The

Whitehorse report endorsed the development of better Australian data and warned against accepting unsubstantiated press reports and market extrapolations based upon imported data.<sup>153</sup> Companies might be required to disclose the number of employees contracted offshore at the end of each financial year and the number of local jobs lost due to offshoring. Data collection might also include laws for federal and state reporting requirements. Better data collection on offshoring for both the public and private sectors would encourage better media reporting on the net impact of offshoring. It would also identify the type of jobs lost overseas and the type of jobs that Australia can retain locally

- *require offshoring companies—and their contractors—to comply with formal conditions.* These two policy proposals have been vetted in the US. First, companies might be required to give workers and the government notice (for example, three months) before being allowed to offshore. Second, offshore contracts might require workers in foreign call centres to inform local customers they are being served abroad. This would require careful amendment of the *Corporations Act 2001* to ensure compliance from all companies operating within Australia, and
- *ensure that companies engage unions in a consultative process.* There is a legal requirement that organisations are required to consult with the relevant unions about redundancies, including consulting on measures to prevent terminations or mitigate their adverse effects.<sup>154</sup> The failure by Qantas to consult with staff prior to its decision to establish a recruiting base in Thailand was a breach the enterprise agreement consultation clause. There are several other industrial relations issues relating to offshoring of which companies need to be aware. For example, there is a freedom of information risk under the *Workplace Relations Act 1996*, whereby litigation may arise if one of the reasons for offshoring is to avoid providing employee benefits contained in an award.<sup>155</sup> Government has an interest in ensuring that the union movement is involved in negotiations on offshoring decisions, and that arrangements are in place to minimise litigation.

The options specific to the IT sector are to:

- *continue promoting ICT exports.* Again, the AUSFTA is an important advance. It will open up the biggest ICT market in the world, including the \$76 billion US Government procurement market, to Australian ICT exporters.<sup>156</sup> The AUSTRADE scheme of Export Market Development Grants reimburses up to half of the expenses incurred on eligible export promotional activities above the first \$15 000.<sup>157</sup> The Australian Chamber of Commerce and Industry is a strong supporter of this scheme, and has urged the government to increase the funding level.<sup>158</sup> Funding is currently capped at \$150 million a year until 2005–06<sup>159</sup>
- *encourage collaborative research and development projects with other nations, including India.* In November 2004, the Smart Internet Technology Cooperative Research Centre announced an agreement with the Indian IT services and consultancy, Infosys, to work together in the research and development of Australian intellectual property.<sup>160</sup> Infosys will invest up to AUD\$800 000 in Australian research and development over the next four

years. The agreement is the first significant commitment by an Indian IT company to joint research and development with an Australian research organisation. The New South Wales Premier, the Hon. Bob Carr, commented: ‘This agreement reflects the type of cooperation between the Indian software industry and Australian high-end research where the greatest opportunities for mutual benefit lie’.<sup>161</sup> Federal and state governments may have a role to identify international project opportunities for Australian IT professionals, especially in South-East Asia,<sup>162</sup> and

- *encourage IT companies to undertake a cost-benefit analysis before making a decision to offshore.* This has been proposed by the Australian Computer Society and endorsed by the Labor Party. The checklist would encourage companies to ‘self-regulate’ their offshoring decision, paying particular attention to contingency plans. AUSTRADE—the agency responsible for providing information to prospective offshoring companies—might also be required to use this checklist.

Some of the policy options suggested in the US debate are not relevant in the Australian context. They include proposals to:

- *reduce or eliminate corporate income taxes.* This approach is designed to compensate for the relatively high labour costs, and thereby enable local companies to remain onshore. However, a lower corporate income tax rate is normally intended to stimulate economic activity and job creation across the whole economy. It should be used for this purpose. Cutting corporate tax rates is unlikely to be either an efficient or an effective measure to prevent Australian companies from offshoring. It would not be possible to offer a specific sector a lower corporate income tax rate
- *provide tax credits for companies that keep jobs at home.* The US Democrats’ proposal to reward onshore companies through tax credits is not appropriate in the Australian setting. As with the option of reducing corporate income taxes, tax credits would be too expensive given that the majority of Australian companies are not offshoring, and
- *ban offshoring altogether.* A partial ban on companies offshoring work might be achieved through use of the corporations power in paragraph 51(xx) of the Constitution. However, a total ban may raise other constitutional issues. In any event, it seems unlikely that either of the major Australian political parties would countenance a blanket ban. There is no proposed legislation dealing with offshoring at either federal or state level.

### Should government services be offshored?

A ban on offshoring Australian government contracts is also an issue. Part IV noted US legislation preventing government agencies from using any offshoring in privatisation or procurement activity. The Australian Labor Party’s policy, as enunciated at its January 2004 National Conference, is:

Labor will ensure that Government and Government Business Enterprises shall not outsource their existing functions to off-shore providers (either directly or indirectly) where those services can be efficiently and effectively provided within Australia.<sup>163</sup>

The Government disagrees. Before the 2004 federal election, senior government ministers signalled their support for federal agencies to offshore IT work. In August 2004, the Hon. Mark Vaile, Minister for Trade, reasoned:

... you can't say we want our technology developers in Australia to compete on the basis of national treatment in markets around the world, but say to everyone else we're not going to let you compete in our marketplace.<sup>164</sup>

The Hon. Helen Coonan, Minister for Communications, Information Technology and the Arts, similarly argued the importance of reciprocity in Australia's trade relations. *The Australian* reported on these comments, noting that three government agencies 'have swung behind Trade Minister Mark Vaile's green light for offshoring'.<sup>165</sup> The Department of Foreign Affairs and Trade, the Department of Defence, and the Department of Communications, Information Technology and the Arts were all mentioned as having an 'in-principle' interest in offshoring.

Following the 2004 federal election, *The Australian* revisited the issue. It suggested that the Howard Government's return 'is likely to spur further offshoring ... in federal government departments'.<sup>166</sup> The paper highlighted two indicative events. First, the decision to move the Australian Government Information Management Office to within the Department of Finance and Administration was seen as a strategic move. The Office, which had canvassed offshoring options for government agencies on its website in June 2004, would now be able to play a whole-of-government advisory role.<sup>167</sup> Second, Telstra's October announcement (Table 3) led to speculation that the company would be a 'trend setter for other government departments'.<sup>168</sup> *The Australian* cited the Department of Health and the Australian Customs Service as the most likely agencies to follow the Telstra lead.<sup>169</sup> The Department of Health has an outsourcing contract with IBM and the Computer Sciences Corporation; Customs has a contract with EDS. By December 2004, *The Australian* reported that Ministers Vaile and Coonan were 'encouraging' Commonwealth departments to use offshore service providers for essential software development.<sup>170</sup>

### The risks in offshoring Australian Government services

At one level, the decision to offshore government IT services is appealing. Government departments are eager to squeeze costs, and service providers are keen to snare the large volume of government IT contracts. However, offshoring government work is potentially a legal minefield. Agencies need to be aware of their legal requirements in entering into contracts that involve an offshore supplier.

The offshoring risk to Australian businesses is lost profits and reputations where things go wrong. Commonwealth government agencies not only face 'value for money' pressures, but

also a range of privacy, security, freedom of information, and intellectual property issues. In particular, agencies need to be aware of relevant provisions of the *Privacy Act 1988* and the *Financial Management and Accountability Act 1997*.

The relevant sections of the Privacy Act are:

- section 95B, which requires agencies to ensure that Commonwealth contracts prohibit breaches of the Information Privacy Principles by either the contracted service provider or a sub-contractor
- sections 14–16, which list the Information Privacy Principles. They include the solicitation of personal information, the storage and security of personal information, access to and alteration of records containing personal information, and limits on the use and disclosure of personal information. Put simply, the principles ‘prevent unauthorised use or disclosure of information’<sup>171</sup>
- section 6, which states that these principles also apply to the offshore (sub)contractor
- section 5B, which states that privacy obligations extend to acts done overseas involving the unauthorised use of personal information about an Australian citizen or resident, and
- sections 50A and 53B, which allow the Privacy Commissioner to substitute a government agency for the service provider or subcontractor in a privacy complaint or determination. This would apply where the offshore provider was bankrupt, although it is not clear if this applies where the provider simply refuses to abide by Australian law.

Clearly, the security of information is imperative. Security concerns dissuaded recent interest in offshoring by both the Australian Tax Office and the Department of Foreign Affairs and Trade.<sup>172</sup> Government agencies that do offshore IT services need to ensure that the contract is tightly worded and well managed to ensure compliance. A breach of security is punished not only by a determination under the Privacy Act, but also under section 42 of the Financial Management and Accountability Act. It states that in the event of a loss of property (including information), ‘the official or Minister is liable to pay to the Commonwealth the amount of the loss’. Commonwealth agencies currently reduce this risk through regular monitoring visits to contractors. For offshoring agencies, the benefits of a cheap offshore contractor must be weighed against the cost—in money and time—of visiting an offshore provider.

Agencies will also need to be conscious of intellectual property issues. Ownership of intellectual property rights, such as copyright, normally depends on the residence of the creating entity. For example, software developed in India is subject to India’s copyright laws.

## Conclusion

The offshoring of service sector jobs is likely to be an issue of growing concern in Australia and throughout the developed world. For private companies and government agencies alike, there will be abundant opportunities to benefit from a cheap and increasingly educated workforce in the developing world. Technological advances will continue to facilitate these opportunities. This Research Brief has focussed on the arguments of two opposing groups in the US and Australian debate. Companies, consumer groups and free market economists all regret the loss of jobs, but emphasise the mutual gains from free trade, and the folly of protectionism. Unions, industry associations and free trade sceptics argue that service sector offshoring contradicts conventional wisdom that some white-collar jobs are immune from low-wage, foreign competition, and should therefore be opposed. The major political parties in both the US and Australia have adopted these opposing views, although the Labor Party's most recent position may temper anti-offshoring sentiment in the Australian Parliament.

This Research Brief has focussed on the 'first-round' effect of offshoring—the loss of jobs. It is important to recognise, however, that increased efficiency from shedding labour could lead to higher production and an expansion of employment in other lines of work.<sup>173</sup> This is the 'second-round' effect. Moreover, despite predictions that some Australian sectors face thousands of job losses in coming years, the extent of offshoring's appeal may yet prove illusory. It is right to assume that cheap labour costs will lure many more Australian companies—and multinationals based in Australia—overseas. It is also true that governments will face more pressure to promote inward investment and enable workers to retrain and move into other fields. However, offshoring companies and offshore providers will also be challenged. Australia currently has a highly skilled workforce, a stable political system, and a sound regulatory environment. These attractions may well outweigh the savings from using cheap foreign labour, particularly if the quality and reliability of the offshore service is lacking.

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