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The Myth of Offshoring

One of the questions that has been coming up in client meetings these days concerns the loss of jobs to foreign countries at the expense of Canadian workers, known as 'offshoring' by the popular press. I have heard quite a bit about radiologists in India interpreting x-rays for US labs, supposedly putting highly-trained Americans out of work.

This concern is an election issue in the US: John Kerry, US Democratic Presidential candidate, is on the front page of newspapers talking about how he will do something to stop the flow of jobs away from the United States. Kerry is trying to make hay out of the storm of protest resulting from the comment made by Greg Mankiw, the current President's chief economic advisor. Mankiw, a Harvard professor, told Congress that 'if a thing or service can be more cheaply produced overseas, then it should be', reported The Economist.

Mankiw is correct. If something can be produced cheaper somewhere else, it should be. Here's why.

The so-called 'loss' of jobs to technological advancement and low-cost labour has been going on since the Industrial Revolution began in the 1700s. At the turn of this century, something like 30% of Canadians were involved in agriculture; today it is about 3%. Agricultural jobs have been lost by the millions … but those jobs have been replaced by jobs that were unimaginable at the turn of the century. And we are all much better off.

Nothing about the subject today changes the principles in any way.

To quote Mankiw, 'no one could have predicted that the grandchildren of farmers would become website designers and CAT-scan operators, but they did'. The US economy has 72 *million* more jobs than in 1964. And at higher incomes, too: the average male income for similar education and occupation has increased 18% since 1964, and females' income is up 38%, after inflation, as reported in an article in the Wall Street Journal.

Very simply, these new production processes, whether they are automotive assembly lines moving to Mexico, x-rays to India, or computerizing an elevator in Toronto, reduce the cost of those goods or services for people buying them here. Those people – you and me – then have money left in our pockets. We use that money to buy other things. Many of those 'other things' that we buy - CDs, airplane tickets, or architectural services, require more technologically advanced workers than the job that was lost. It is part of the endless process of advancement.

One of the things that seems scary about the subject of losing jobs overseas is the numbers of people involved. The papers talk about hundreds or even thousands of jobs, and to us that seems like a lot. However, in the context of the total number of jobs lost and generated in the economy each month, the number is very small.

For instance, The Economist reports that the US economy creates and destroys about 2 *million* jobs per *month*. This is called job 'churn'. Companies fold up and go bankrupt, new companies are formed, and existing companies either add or subtract workers as their customer flow requires.

Of the roughly 175 million jobs in the US today (according to The Wall Street Journal), a churn of 2 million per month is 24 million per year; or about 1/7 of the total number of jobs. That's a lot of people changing jobs.

But the important point is that an increase or decrease in the unemployment rate is only the difference in total jobs created or lost out of that 2 million churn each month. Overall, the number of jobs going overseas is a tiny fraction of the total number of jobs created and lost each month.

In addition, the US economy has historically created a few more jobs, each year, on average, than it has lost. These jobs add up to a net increase of 24 *million* US jobs over the 1990s, according to The Economist. So we aren't talking about a net job loss after all.

Not only that, but the jobs being lost are usually not the ones we want anyway. Generally speaking, any job that follows a simple set of rules will either be automated or sent overseas. For example, a straightforward income tax return just follows a few rules; and tax software can be operated easily with little expertise. Similarly, (people tell me) crunching out the millions of lines of computer code for software programming is frequently routine and can be done by someone with minimal training.

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On the other hand, preparing a complex tax return, teaching, making a difficult diagnosis, or designing an advertising strategy all require expert judgement that only an experienced person, familiar with local knowledge, can provide. These jobs, according to The Wall Street Journal, are not likely to be exported.

What should really scare us is the idea that anything could be done to stop the so-called job loss. Kerry is promising (for now anyway) that he would prohibit the US government from buying things from overseas. The US taxpayers should NOT be happy to hear this. Why should the government pay more for something when it can save taxpayer money by buying overseas?

People somehow like the idea of 'buy Canadian', but why should we taxpayers pay more for something than we need to? For instance, why should the Canadian government have to pay more for army boots to be made in Canada when they can be made in Czech for half the cost? Or, to put the shoe on the other foot, why should a Canadian boot manufacturer benefit from a government policy (he gets to make boots) while the stuffed toy manufacturer loses jobs to the Chinese?

Keeping a job in Canada is superficially appealing: we all dread the prospect of having to change jobs or careers. Unfortunately, protecting jobs is not a good answer. To see why, allow me to stretch your time horizon a bit. If it were a good policy idea to protect someone from having to change jobs we might still have people making buggy whips, or ploughing fields by hand, or we might not have fax machines.

If we decided to enact legislation of some sort to prevent jobs going overseas or being replaced by technology, how would the legislation work? Deciding which jobs should go and which should stay is simply impossible. For example, the Bureau of Labor Statistics (BLS) in the US tracks jobs and employment data; it would likely be in charge of such a 'keep work at home' project.

In 1988, the BLS attempted to predict how many of various jobs there would be in 2000, at the time 12 years away.

How did they do? The BLS predicted that travel agents would be one of the fastest growing groups, growing by more than 50% by 2000. Probably a reasonable guess in 1988, but wrong: the number of travel agents fell by 6%, even though travel increased tremendously.

According to the Wall Street Journal report, of the 20 occupations that the BLS predicted would decline the most between 1988 and 2000, half actually grew. For example, the number of electrical equipment assemblers was predicted to fall 44% - another reasonable guess, given robotics and imports – but the number actually grew by 11%. In other words, we have little idea of which occupations are growing and which are declining.

The reason we have no idea is very simply that the factors influencing the birth or demise of an occupation may not exist yet. No one had heard of the internet in 1988. We barely had fax machines back then.

If we have no idea what occupations are growing and what are shrinking, it would be folly to implement a policy to control entry to and exit from those jobs.

The fact is that the world economy is a fantastically complicated and chaotic system. It is, like most things in nature, generally cyclical but full of highly unpredictable things. Very few people have the same job now that they'll have in 10 years or even 5 years. (If you have the same job, you are likely doing it very differently). Any attempt to control or even manage this chaos is doomed to failure – the Russian Communists are only a recent case of the failure of central planning.

And you should be very wary of any politician who tries to control the economy – he doesn't know what he's talking about.

Globe & Mail Article

The Globe ran a series of articles during the week of June 21st to 25th attempting to cast the mutual fund industry in a negative light. The articles were thin on facts, heavy on innuendo, and had a sneering, jealous tone. If you have any questions about specific issues raised in the articles, please e-mail me at choran@assante.com or call Barb at my office (416) 646-3836 for an appointment. I'm happy to discuss any questions you may have.

Summer Reading

Here's a timely trilogy on what may be the most important theatre of world events. Together these books may explain a bit about my personal opinion on the US military invasion of Iraq.

1. The Middle East
   by Bernard Lewis
   Phoenix Press

   A quick and insightful flight through 2000 years of the Middle East. Lewis takes us crisply through the history, providing insights into the ebb and flow and is refreshingly free from slanted opinion.

2. Revolt in the Desert
   by T E Lawrence
   Garden City Publishing, 1926

   The original story of 'Lawrence of Arabia', the book is free of political correctness and provides a young English officer's look into the Arab traditions and tribes.

3. The Rock, A Tale of 7th Century Jerusalem
   Kanan Makiya
   Pantheon Books

   A short historical novel written from the eyes of a boy in 7th century Jerusalem whose father arranges the peaceful occupation of Jerusalem by the invading Muslim Turks. A fascinating look at the rock at the centre of the world's 3 monotheistic faiths.