

Apocalypse Soon? Why Alan Blinder Gets it Wrong on Offshoring

Robert D. Atkinson

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In a recent article in *Foreign Affairs* entitled “Offshoring: The Next Industrial Revolution,” noted economist Alan Blinder presented a provocative and disturbing thesis: the offshoring of service sector jobs is not just a routine extension of international trade, but a “third industrial revolution” likely to lead to one of every three American jobs being shipped overseas.¹ Blinder warns that, “We have so far barely seen the tip of the offshoring iceberg, the eventual dimensions of which may be staggering.”

Even though he claims this revolution will lead to a “massive transition” in the labor market,² Blinder puts a good a face on this “coming wave of offshoring,” encouraging Americans to get used to their new jobs as divorce lawyers and salespersons, and correctly counseling that it would be a mistake to erect protectionist walls. But that’s little consolation to the average person who, according to Blinder, is now playing Russian jobs roulette (Indian roulette?) with two bullets in the chamber as they purportedly face a one in three chance of having their job swept out from under them.

When an economist of Alan Blinder’s stature (former member of President Clinton’s Council of Economic Advisors and Vice Chairman of the Board of Governors of the Federal Reserve) speaks, people listen.³ Unfortunately, in this case they shouldn’t, since Blinder’s projections are vastly exaggerated.

Traded and Non-Traded Jobs

To understand Blinder’s analysis it’s important to understand the difference between “traded” and “non-traded” jobs. Traded jobs are found in industries, such as food processing and steel production, whose output is sold outside of the relevant market area. In contrast, jobs in industries where the output is purchased principally by local area residents – e.g., jobs at Kinkos, Starbucks, elementary schools, and nursing homes – are non-traded.⁴

Historically, traded jobs were concentrated in manufacturing and natural resource industries (as Blinder says, things that could be shipped in boxes). It's only within the last decade that many information-based services have been subject to the same kind of dynamics. With the IT revolution, many information-based services can now be provided at a distance. Workers writing code for packaged software, staffing call centers, and providing consulting services usually sell their services outside their local economic region. Indeed, almost daily we read or hear how service sector jobs are going offshore to places like India, Eastern Europe and other lower-wage nations. As a result, many of what were once non-traded jobs (at least from the perspective of the nation as a whole) are now traded (or at least tradable).

How Many Service Sector Jobs Are Going Offshore?

So how many service sector jobs are likely to go offshore? Before answering this, it's worth looking at how many have already gone offshore. Unfortunately, given the lack of data, it's impossible to say with any level of precision. However, estimates suggest that the number has been relatively modest, fewer than 1 million jobs or "less than two weeks' worth of normal gross job loss," according to Blinder.⁵ However, most careful studies suggest that this number is likely to increase as technology improves and companies gain offshoring experience. But the \$64,000 question is how many U.S. service sector jobs are likely to be offshored in the future.

Until Blinder's article, the most widely cited projection was produced by Forrester Research's John McCarthy. McCarthy projected that 3.4 million U.S. jobs would be

offshored between 2000 and 2015. But according to Blinder, that number, considered by some as too high, is actually "way too low."

While McCarthy estimated the number of jobs likely to be offshored, at least three other studies have estimated the number of jobs that could potentially be offshored. U.C. Berkeley economists Bardhan and Kroll estimate that up to 11 percent of total employment, or 14 million service sector jobs could be offshored.⁶ Federal Reserve Bank economist C. Alan Garner came up with the same estimate.⁷ Using a similar methodology I estimated that 12 million jobs could potentially be offshored.⁸ All three studies caution that just because a job could be done offshore, that does not mean that it will be. With reference to these estimates, however, Blinder also thinks they are too low.⁹

So how many service sector jobs does Blinder think are at risk? Blinder argues that virtually all jobs not involving personal direct face-to-face interaction could be offshored and that "the total number of current U.S. service-sector jobs that will be susceptible to offshoring in the electronic future is two to three times the total number of current manufacturing jobs." In other words between 28 and 42 million service-sector jobs are at risk (along with an additional 14 million manufacturing jobs). This doesn't mean that all these jobs will be lost. But while Blinder acknowledges that "the third Industrial Revolution will not drive all impersonal services offshore," their share of the workforce "will shrink dramatically."¹⁰ In fact, according to Blinder, in a generation or two, "only a small minority of U.S. jobs will still be offshorable; the rest will have moved offshore."¹¹

How Blinder Overestimates the Offshoring Risk

In overstating the number of jobs likely to be offshored (probably by a factor of 10) Blinder makes three critical errors. First, he overestimates the number of jobs that are tradable. Second, he overestimates the share of those jobs likely to be offshored. And third, he omits the offsetting increase in service sector jobs from expanded exports. Let's examine each misstep.

First, Blinder overestimates the number of jobs that are offshorable. One reason he comes up with numbers significantly higher than the three studies cited above is that Blinder believes that the future pattern of offshoring will be significantly different than today's. He criticizes Bardhan and Kroll for limiting their analysis to occupations where at least some outsourcing has taken place or is being planned. According to Blinder, that limits "these researchers to looking only slightly beyond the currently visible tip of the iceberg."¹² But in fact, while the number of jobs offshored could increase, it's not likely that the current occupation pattern will change significantly. Most jobs at risk of offshoring today or in the near future are likely to be at risk in twenty years, while jobs not at risk today are likely to not be at risk in the future. The technological transformation that enables service-sector offshoring – cheap and powerful telecommunications¹³ and computing, ubiquitous and interoperable networking, and the proliferation of standard software packages – has enabled many different service sector functions to be offshored. But since this core underlying technology system is not likely to change in significant ways over the next 25 years (beyond getting cheaper and more powerful), it's unlikely that occupations that McCarthy, Bardhan and Kroll, Garner and Atkinson did not see at risk will become at

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risk. For example, it's unlikely that occupations like chief executives or bank tellers will see their jobs offshored in the future (although many of the latter could see their jobs automated), even though as information functions it would be technologically possible to conduct them from offshore.

Second, Blinder assumes that most jobs in occupations and industries that could be offshored will be offshored. But there are several reasons why this is not likely to be true. First, many small and mid-sized firms (who employ around two-thirds of the workforce) are unlikely to outsource many jobs, much less offshore them. They might outsource some specific functions (such as IT support or printing) but they are not going to outsource all their jobs, especially core functions (and most of these outsourced functions are likely to be done in the United States.)

Moreover, many individual jobs that involve multiple functions are not likely to move, even if some are routine functions and could be done remotely through IT. For example, if part of a job involves work that requires face-to-face client contact and a part that doesn't, the entire job has to remain near clients. There are other reasons to be skeptical about Blinder's claim that most tradable jobs will be offshored. For example, firms in markets that place a premium on customer service may be hesitant to place customer service job functions overseas where there may be problems with accents, lack of knowledge of U.S. society, and skills.¹⁴ Moreover, even if work could be done remotely in offshore locations, for many functions, particularly knowledge-based information activities, the value of being "in the loop" will mean that these jobs will remain in big U.S. metropolitan areas.¹⁵

Third, the most important reason why Blinder's estimates are vastly overstated is that he forgets about exports. Blinder assumes that the U.S. economy will increasingly specialize in non-traded jobs while the rest of the world (at least low wage countries) will specialize in traded jobs. As a result, he argues that "the United States will have to reorganize the nature of work to exploit their big advantage in non-tradable services ... specializing in the delivery of services where personal presence is either imperative or highly beneficial."

But this scenario is impossible. If other countries produce traded goods and services for us and we produce non-traded goods and services also for us, what do the other countries get in return for the traded goods and services they send us? By definition non-traded goods and services, which Blinder says we will specialize in, can't be traded. So if we are producing very few traded goods and services, what will we export to pay for our imports?¹⁶ They call it "trade" and not "charity" for a reason. Countries export goods and services so they have foreign exchange to pay for their imports. If the United States isn't exporting much to other nations, then why will they keep exporting to us? To put it another way, Blinder's scenario where the United States produces vastly fewer tradable goods and services (but presumably continues to consume the same amount of tradable goods and services, such as DVD players and calls to Indian call centers), would mean that the trade deficit would balloon from the already massive \$750 billion annual deficit to around \$5.5 trillion.

But long before the trade deficit grew that large the value of the dollar would fall to make our imports more expensive and our exports cheaper. In fact, the main reason why it appears to some, including Blinder, that virtually all our traded industries appear to be at an absolute cost disadvantage in international trade is because foreign

governments have thwarted market forces from driving the value of the dollar down relative to other currencies. If this distortion were removed we would see a more market-based allocation of traded-sector production; with the trade deficit declining and the United States specializing even more in higher-skilled, higher value-added goods and services, and countries like China and India specializing in lower-skilled, lower-value added production. This means that assuming that markets set the price of currencies, and not governments, the United States may lose some lower-value added information-based service jobs, but that it will also gain higher value-added information-based service jobs to make up for the ones lost.

In ignoring this key fact of international trade, Blinder ends up advancing a new theory of comparative advantage where the United States no longer specializes in higher-value added, skill-based activities, but instead in local-serving, non-traded activities. This leads him to conclude that "since the distinction between personal services (likely to remain in rich countries) and impersonal services (likely to go) does not correspond to the traditional distinction between high-skilled and low-skilled work, simply providing more education cannot be the whole answer."¹⁷ But in a world where the United States competes in the global economy to specialize in higher-value added exports, education and skills in fact become an important part of the answer. Boosting the quality of American education, from elementary school through higher education and all the way to adult lifetime learning, will help the U.S. economy specialize even more in higher value-added, higher-skilled jobs and industries.

Conclusion

For much of the 20th century it was states and cities that focused on the distinction between traded and non-traded jobs. If an

automobile factory closed, the impact would ripple through the local economy as laid off workers cut their purchases at local serving businesses (e.g., barbers, lawyers, etc). This is why virtually all states and cities created economic development policies focused on retaining and creating jobs in traded industries, especially ones paying higher wages.

In contrast, because relatively few products were imported or exported, the federal government has until recently paid less attention to the important role of traded industries. But as the share of the U.S. economy that is traded globally has expanded, that has begun to change.¹⁸ Now, with the national economy structured like many state economies half a century ago in

terms of how much of the economy is traded (globally in the former, regionally in the latter), the federal government needs to think more like state governments, and focus on how to attract and retain higher-wage “traded” sectors. This means enacting policies to expand the share of skilled workers, boost support for research, foster digital transformation of the economy, and take other steps to boost the competitiveness of the U.S. economy.¹⁹

Giving up America’s traded sector as Blinder proposes is a strategy for long-term decline. Working to ensure that we win in the international competition for higher paid traded jobs is a strategy for long-term prosperity.

ENDNOTES

1. Alan Blinder, “Offshoring: The Next Industrial Revolution” *Foreign Affairs*, March/April 2006, p. 126.

2. Ibid.

3. Indeed, this is not just an idea that appears in a journal. The press has picked up on it. See Peter G. Gosselin, “Good Education May Not Be Enough,” *Los Angeles Times*, March 6, 2006.

4. Traded jobs can even include some kinds of jobs not normally thought of as traded, such as hotel and restaurant workers, if those workers are providing services to tourists.

5. Blinder, “Offshoring,” p. 114.

6. Ashok D. Bardhan and Cynthia Kroll, “The New Wave of Outsourcing,” (Berkeley, CA: Fisher Center For Real Estate and Urban Economics, UC Berkeley, 2003).

7. C. Alan Garner, “Offshoring in the Service Sector: Economic Impact and Policy Issues,” *Economic Review*, Third Quarter 2004, pp. 5-37.

8. This was calculated by classifying U.S. occupations on their likely propensity to be able to be performed remotely through IT. For example, occupations that are included are bill and account collectors, customer service representatives, medical transcriptionists, survey researchers, architectural and civil drafters, paralegals, and insurance underwriters. Robert D. Atkinson, “Understanding the Offshoring Challenge,” (Washington, DC: Progressive Policy Institute, 2004).

9. Blinder, “Offshoring,” p. 120.

10. While Blinder tells us that while “coping with foreign competition ... is now on the radar screens of only a minority of workers in rich countries,” it “may become a major concern of the majority.” Blinder, “Fear of Offshoring,” p. 12.

11. It's possible that in a generation or two a much smaller share of jobs will be offshorable, but if this occurs it will be because it is easier to boost productivity in traded sectors (e.g., manufacturing, mining, agriculture and information-based services) than in non-traded sectors, and therefore their share of the workforce may shrink. But their share won't shrink because of trade.
12. Alan Blinder, "Fear of Offshoring," CEPS Working Paper No. 119, Princeton University, December 2005, p. 15.
13. A three-minute telephone call between London and New York City cost \$70 in today's dollars in 1964, but less than 50 cents today and probably close to zero as we move to Internet telephony.
14. For example, Dell Computer recently brought back some customer assistance jobs that had been located in India because it realized that the quality of the jobs (and the ability of the workers to better communicate with American customers) was higher in the United States.
15. As a result, while the routine economy may be dispersing, the innovation economy remains spatially concentrated, particularly in more complex activities undertaken by managers, professionals, and executives in industries such as accounting, law, consulting, and functions like corporate and regional headquarter offices.
16. It is theoretically possible, although unlikely, that workers in foreign nations would sell us traded goods and services and then come to the United States to consume our non-traded goods. For example, they could come to the United States to stay in nursing homes, get their haircut, or visit Graceland.
17. Blinder, "Offshoring," p. 127.
18. While the sum of exports and imports never exceeded 8.5 percent of GDP between 1929 and 1970, in the 1970s they began to take off, growing to 16.9 percent of GDP in 1980 and almost 24 percent in 2000. As a result, U.S. trade went from \$19 billion in 1950, to \$84 billion in 1970, to \$466 billion in 1980 and to \$2.5 trillion in 2000 (in constant dollars). In 2000, almost 18 million U.S. jobs were directly linked to international trade, investment, or tourism.
19. For specific recommendations, see Robert D. Atkinson, "If We Build It Will They Come, Is the U.S. Policy Response to the Competitiveness Challenge Adequate to the Task?" (Washington, DC: The Information Technology and Innovation Foundation, May 2006) <www.innovationpolicy.org/pdf/aaasfinal2006.pdf>.

About the Author:

Dr. Robert D. Atkinson is President of the Information Technology and Innovation Foundation. As former Director of the Progressive Policy Institute's Technology and New Economy Project, Executive Director of the Rhode Island Economic Policy Council and Project Director of the Congressional Office of Technology Assessment, he has conducted groundbreaking technology research, advised policy makers, and written and spoken extensively on tech issues. He is the author of *The Past and Future of America's Economy: Long Waves of Innovation that Power Cycles of Growth* (Edward Elgar: 2005).

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ITIF • 1250 I St. N.W. • Suite 200 • Washington, DC 20005