Chapter X

Sourcing and Outsourcing Arithmetic

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Abstract

This chapter studies outsourcing from the United States to India. First, we show that outsourcing is not taking most jobs out of the United States. Second, we argue that outsourcing does not contradict trade theory. Third, we analyze how India has come to occupy a preeminent position in outsourcing. Fourth, we show that the Indian dominance is likely to continue well into the next decade. Finally, we discuss some risks associated with outsourcing.

Introduction

The Greek philosopher Seneca said over 2 millennia ago, "There is nothing new under the sun." Outsourcing is nothing new either. It is well known that the Roman Empire had outsourced tax collection in far-flung places. As a result, a recurrent theme in Edward Gibbon's historical treatise, *The History of The Decline and Fall of the Roman Empire,* is that the decline is attributable, to some extent, to outsourcing.

In the eighteenth and the nineteenth century, England outsourced, to private contractors, the maintenance and operation of streetlights, the management of prisons, and the repair of public highways. However, historically, most outsourcing has been associated with "non-essential" services. PriceWaterhouseCoopers defines outsourcing as "the long-term contracting out of non-core business processes to an outside provider to help achieve increased shareholder value" (http://www.pwcglobal.com). On the other hand, Gartner Group defines it as "the delegation of one or more IT-intensive business processes to an external provider that, in turn, owns, administrates and manages the selected processes based on defined and measurable performance metrics." Unlike PriceWaterhouseCoopers, Gartner avoids any reference to noncore business, it focuses instead on information technology (IT). Outsourcing of strategic business services is relatively new. It started with Eastman Kodak outsourcing information technology (IT) to three external partners in 1989.

During the 2004 presidential election in the United States, it riled the political world so much that the Coalition for Economic Growth and American Jobs suggested that instead of calling the phenomenon "outsourcing," we should use a more neutral term, "worldwide sourcing" (Koffler, 2004).

The loss of white-collar jobs due to outsourcing has prompted many U.S. state governments to ban foreign contractors from bidding altogether. In a telling example, the governor of Indiana canceled a $15 million contract with an Indian company to process state unemployment claims. The next-lowest bidder, an American firm, was eventually given the same job for $23 million (Maranjian, 2004).

In this chapter, *we focus on outsourcing from the United States to India because the United States has become the largest outsourcing country whereas India has become the largest host country.* In that context, we first put outsourcing in proper perspective in terms of job losses. Second, we discuss outsourcing in the context of trade theory. Third, we discuss the reasons and the types of outsourcing. India has become the focus of the entire outsourcing debate because a substantial number of outsourcing contracts in the past 10 years between developed and developing countries have gone to India. Therefore, we discuss how and why India has become such an important source of outsourcing. Finally, we discuss outsourcing risks.

Outsourcing in Perspective

In 2002, John C. McCarthy of Forrester Research estimated that over a period of 15 years, some 3.3 million jobs would go offshore as a result of outsourcing (McCarthy, 2002). Of

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