

MMPA 6180 - Policy Analysis

Outsourcing Policy Paper

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## Executive Summary

Outsourcing, especially the use of foreign vendors, has become a highly controversial issue as the U.S. suffered a series of recessions starting in 2001. This paper examines the drawbacks and benefits of outsourcing and concludes that there is a potential for significant economic disruption to the American economy. The issue of outsourcing public services is also examined with the findings that outsourcing is endangering the values of public service and usurping the managerial powers of public administrators. Five alternatives ranging from an outright ban on outsourcing to no interference with outsourcing are examined and it is suggested that the best policy alternative is to provide tax incentives to corporations that create new jobs to replace jobs lost through outsourcing and for providing safe working conditions and a livable wage for foreign workers. It also suggested that if tax incentives are not enough, then the government should require corporations to create new jobs and to treat foreign workers well.

## Policy Outcomes

### *Background*

Outsourcing is defined as "the contracting out of functions, tasks, or services by an organization for the purpose of reducing its process burden, acquiring a specialized technical expertise, or achieving expense reduction" (Garaventa & Tellefsen, 2001, p. 28). When outsourcing involves sending work to a foreign country, it is known as offshoring (Millman, 2003, p. 55). Outsourcing has been an accepted business practice since after World War II but the Internet greatly accelerated the practice of outsourcing service jobs in the late 1990s. When the U.S. suffered a series of recessions starting in 2001, the issue of outsourcing entered the policy agenda with the current Republican administration defending the practice while the Democratic 2004 Presidential candidate promising reform.

### Scope and Severity of Problem

#### *Assessment of Past Policy Performance*

There has been a lot of discussion on the issue of outsourcing and specifically offshoring, but very little has been formally done on a legislative level mostly due to organized and consistent resistance from the American business community.

#### *Significance of Problem Situation*

Outsourcing costs is a multi-billion dollar industry that is expected to rapidly grow in the near future (Qu and Brocklehurst, 2003, p. 53) with an estimated loss of 500,000 jobs in information technology over the next two years (Reaser, 2004, p. 96) and a total loss of four million service jobs over the next five years (p. 96). U.S. worker pay

has also been lowered as American workers have had to compete against their lower-paid foreign counterparts (Chabrow, 2004, p. 20). And as more processing of health care and personal financial information is being performed overseas, privacy risks and quality concerns have risen (Vijayan, 2004, p. 10; Mintz, 2004, p. 10). A specific concern to public agencies that outsource is the erosion of public values and loss of policy control to outsourcing vendors (Peled, 2001, p. 507).

### *Need for Analysis*

Whether one agrees that outsourcing is beneficial or detrimental to the U.S. economy, it is a substantial economic phenomenon that is rapidly growing and has global impact. The increasing concerns over privacy, quality of vital information, and the impact on public agencies requires that policymakers address this issue and determine standards that will safeguard customer and citizen rights while minimizing the impact to the U.S. economy and preventing the exploitation and abuse of foreign workers.

## Problem Statement

### *Definition of Problem*

Outsourcing is the business practice of contracting with other companies to perform business operations that were originally performed in-house. In the past, American companies outsourced with other American companies but, with the advent of the Internet and inexpensive computer equipment, more and more foreign companies have become outsourcing vendors. This practice, called offshoring, has generated much debate especially as the U.S. economy has suffered major job losses since 2001. The

following sections demonstrate that outsourcing will increase and the criticisms against outsourcing. The final section argues that outsourcing is not a problem and may be beneficial to the U.S. economy.

#### *Outsourcing to increase*

In 2000, U.S. companies spent \$5.5 billion in offshoring and are projected to spend over \$17.6 billion by 2005 (Qu and Brocklehurst, 2003, p. 53). India, which provides 80% of the world's outsourcing for IT, expects total export growth of \$23 billion in 2005 and \$50 billion in 2008 (p. 53). This demonstrates that offshoring will be a growing policy issue throughout the decade.

#### *What is being outsourced*

During the 1970s and 1980s, manufacturing was the only industry being outsourced. In the late 1990s and currently, services are also being outsourced. "The most typical functions that are sent overseas are finance and accounting, human resources, customer service, information technology, sales and marketing, operations, engineering and development, procurement, real estate and facilities management, and environment, health, and safety operations" (Williams, 2003, p. 19). These service industries were traditionally the bastion of high-paying American jobs and currently the sources of the most job losses.

*Outsourcing depresses pay*

Along with the loss of jobs, pay in the affected service areas has steadily declined as remaining American workers have had to compete with their lower-cost counterparts in India and China (Chabrow, 2004, p. 20). Meanwhile, the pay for project managers who manage teams consisting of offshore employees has increased 7% from 2003 (p. 20).

*Reduces innovation*

Stanford Graduate School of Business researchers will soon publish the results of their studies on outsourcing. One finding is that "outsourcing to contract manufacturers may ultimately harms some OEMs [original equipment manufacturers] by, among other factors, reducing incentives to innovate" ("Downside", 2004, p. 17).

*Western firms squeezing out Indian firms*

As outsourcing and offshoring grow, large information technology firms are establishing software development centers in India thus competing with local Indian firms for business and employees (Kumra and Sinha, 2003, p. 42). This is causing profit margins for Indian information technology firms to fall (p. 42). Firms such as Accenture, EDS, Microsoft, and Oracle have already established centers in India and hope to capture a growing share of the services market such as marketing and operations (p. 42). Thus, pay will continue to remain low for Indian workers while more American jobs flow to the offshore development centers.

### *Decreased morality*

In an article by Arnold and Bowie (2003), they argue that companies that outsource have a moral obligation under Kantian ethics to ensure that workers are granted their legal rights, (p. 228) that they are not coerced into working, (p. 231) and that they receive a livable wage (p. 234). As current conditions demonstrate, these moral imperatives are not being observed (p. 221). Thus, because companies are assumed to be composed of moral people and these companies are uniquely positioned to improve the lot of the poor, outsourcing that is based on underpaid employees working long hours in unsafe conditions ultimately harms the companies themselves (p. 239).

### *Loss of privacy*

"Outsourcing jobs to offshore locations can sharply increase data privacy risks and the complexity of managing them," according to participants at the Fourth Annual Privacy and Data Security Summit held in 2004 (Vijayan, 2004, p. 10). As Vijayan reports, vendors have no obligation to respect privacy and breaches of privacy are harder to contain when the team and management are separated by long distances (p. 10). As more and more service industries rely on outsourced workers, privacy breaches will only increase.

To take one example, there is a major debate among accounting professionals concerning outsourcing the processing of tax returns. Under the Internal Revenue Code section 7216, anyone who is involved in tax return preparations cannot "knowingly or recklessly" disclose personal information (Miller and Anderson, 2004, p. 34). Therefore, companies that outsource tax preparation are under an obligation to insure that a vendor

will safeguard the information. But Miller and Anderson also argue that section 7216 does not require tax preparers to inform clients that an outsourcing vendor was used. Steven Mintz, counters that there is a duty to inform and that the accounting firm is placing its own interests in reducing costs above the client's right to privacy and thus this is unethical (Mintz, 2004, p. 10). The same argument can be made for any industry that handles sensitive data.

#### *Abdication of management*

[E]ven though outsourcing is currently very fashionable, it can have quite a few serious disadvantages. Not only can it be difficult to administer effectively, but it also runs a serious risk of resulting in higher costs and in lower quality and service. Fundamentally, it represents an abdication of management! (Wentworth, 2003, p. 59)

As Wentworth argues in his article, outsourcing relationships based on price concerns can lead to four problems. First, there is a loss of control over quality and service (Wentworth, 2003, p. 57). Second, there is no incentive for the outsourcing vendor to be efficient (p. 58) while third, there is a danger of a vendor lock-in that will lead to escalating costs (p. 58). Fourth, the company loses any control over the future once the contract is implemented (p. 58). In essence, outsourcing puts the vendor in control of company decisions and places the client in a position where they have to rely on the vendor's commitment to quality and service (p. 57).

Doig, Ritter, Spechhals, and Woolson's (2001) example of the Gibson Greeting Card Company is an example of Wentworth's arguments. Gibson Greeting, the oldest greeting-card maker, experienced cash flow problems in the 1990s and began outsourcing to save money. Because of "supplier-management problems" with the outsourcing

vendors, Gibson was eventually acquired by a competitor (p. 26). As Doing, et. al. point out, "20 to 25 percent of all outsourcing relationships . . . fail within two years and that 50 percent fail within five" (p. 27). This high failure rate greatly imperils companies because their operations are beyond their control.

### *Loss of public values*

Public agencies face the same negatives of outsourcing as business enterprises but outsourcing poses an additional challenge peculiar to government organizations.

Jorgensen and Bozeman (2002) list thirteen values that public agencies must preserve as parts of a representative democracy: "political accountability," "rule of law," "equal treatment," "regime stability," "balancing of interests," "transparency," "professional standards," "personal altruism and engagement," "employee safety," "social cohesion," "local self-governance," "involvement of citizens," and "user orientation" (pp. 67-69).

These are the values that public agency employees are sworn to uphold in serving the public. But, as public agencies turn to outsourcing, these values are not being upheld by the vendors. As Peled (2001) points out, "[p]ublic administration scholars have warned that consultants today enjoy greater management responsibilities for government programs than ever before and that a handful of demoralized, politicized, and incompetent bureaucrats cannot control them" (p. 497).

Despite the inability of outsourcing vendors in upholding public values, Peled (2001) demonstrates four reasons why public managers need to outsource. First, public managers just cannot keep up with technology (p. 501). Second, public managers are unable to separate planning from execution (p. 502) and, third, they have no way to

measure successful execution of information technology projects (p. 502). Finally, public managers cannot hire the best technical people due to inadequate agency budgets (p. 503). Thus, public managers are forced to turn to outsourcing and give substantial control of agency decisionmaking to consultants.

By gradually assuming responsibility for the vision, design, execution, and marketing of public IT projects, the new consultants reversed the traditional role of old consultants who were subordinated to the bureaucrats who hired them. Today, new IT consultants structure the work responsibilities of bureaucrats rather than the other way around. (Peled, 2001, p. 507)

Along with the degradation of public values, outsourcing of governmental functions also leads to the "revolving doors" problem "where government employees leav[e] the public sector to manage the very same programs they once regulated" (p. 509) and the "professional affinity" problem with "government officials feeling closer to their proxies than to higher-level governmental officials" (p. 509). Ultimately, as Peled argues, outsourcing of public services leads to more red tape and increased privacy risks and thus, any gains realized are wiped out by the greater drawbacks of outsourcing (p. 509).

#### *Outsourcing is beneficial*

The advocates of outsourcing counter these arguments with five claims of their own: there is little impact from outsourcing to the U.S. economy, the job loss due to outsourcing is exaggerated, most jobs cannot be outsourced, outsourcing creates value for the U.S. economy, and offshore outsourcing helps the foreign worker. In many cases, advocates argue that opponents are projecting the worst aspects of outsourcing and that they have very little real data that proves outsourcing is harmful to the U.S. economy.

Turning to the first claim, advocates argue that outsourcing is a small part of the U.S. economy and thus its impact is limited.

The United States today has more than 130 million employed workers. According to the Organisation [sic] for Economic Co-operation and Development, it has the highest rate of reemployment of any OECD country by a factor of almost two. Over the past ten years, 3.5 million private-sector jobs a year have been created, on average, for a total of 35 million new jobs, so most workers who lose their positions to find another within six months. Jobs lost to low-cost foreign competitors are not so easy to replace. Nonetheless, from 1979 to 1999, 69 percent of the people who lost jobs as a result of cheap imports in sectors other than manufacturing were reemployed. The mean wage of those reemployed was 96.2 percent of their previous wage. (Agrawal & Farrell, 2003, p. 38)

Others agree with these conclusions such as the *Economist* magazine when it wrote that American economy's churn rate is greater than the jobs loss to offshore outsourcing and thus more American jobs will be created than lost ("Hollowing-out", 2004, p. 27). At most, only 3.3 million jobs will be lost overseas by 2015 and many of these jobs are tedious clerical tasks that would have been lost to automation anyway (p. 28-29). And this trend should slow according to Robert Reich (former Labor Secretary) as the "threat of intellectual property loss and quality control problems" continue to mount (Lundquist, 2004, p. 26).

Turning to second claim, advocates argue that the massive job losses projected by outsourcing opponents are wildly exaggerated. The best estimates of consulting firms such as Gartner and Deloitte Consulting demonstrate only a potential 3.5% to 4% job loss to the overall U.S. economy and, at the most, a 5% job loss in the information technology sector (Reaser, 2004, p. 96; see also Williams, 2003b, p. 19).

Even if there are job losses due to offshore outsourcing, advocates argue that the benefits to the U.S. economy more than make up for the potential job losses. For every

dollar that is spent overseas, foreign firms buy \$1.05 for legal services and computer equipment from the U.S. (Agrawal & Farrell, 2003, p. 37). Add to this an additional four cents created by repatriated earnings (p. 37) and the creation of higher-paying jobs in newly-created service areas (p. 37) and the U.S. actually receives back more than what is sent overseas (see also Nelson, 2003). Demand for highly-skilled information-technology jobs will increase in the near future along with other white-collar professions ("Hollowing-out", 2004, p. 29) thus offsetting the relatively small number of projected job losses.

Another claim that advocates argue is that only a small proportion of U.S. jobs can be outsourced. These are mainly tedious clerical or data processing tasks that can just as easily be automated. "Some 70 percent of jobs in the United States are in service industries such as retailing, catering, and personal care. This work, by its very nature, cannot be moved abroad" (Agrawal & Farrell, 2003, p. 36). Thus, the impact of job losses is small, the loss is exaggerated, and there is a limit to the ultimate number of jobs that can be outsourced.

Finally, advocates argue that not only does the U.S. benefit from outsourcing but so does the foreign worker. These workers have a great ability to learn on the job and thus are able to achieve a higher standard of living as their productivity rises (Lewis, 2003, p. 4). As Lewis argues, all nations start with a poorly-educated workforce but rapidly increase their standard of living as they receive on the job-training (p. 4). Thus, outsourcing can be a major force in helping developing countries create a better future for their citizens.

### *Major Stakeholders*

There are a multitude of stakeholders due to the global impact of the outsourcing issue. For purposes of this analysis, the major stakeholders are the citizens of the U.S., the U.S. business community, and the public agencies of the U.S. Minor stakeholders are the foreign governments of outsourcing vendors, foreign workers of the outsourcing vendors, and Western corporations that have relocated some or all of their operations to developing countries.

### *Goals and Objectives*

There are three goals in crafting a policy toward outsourcing. First, to minimize the impact on the U.S. economy by preventing job losses and creating new, high-paying jobs to replace jobs that have been outsourced. The second goal is to prevent the abuse and exploitation of foreign workers caused by either outsourcing contracts or the domination of foreign economies by western corporations. The third goal is to preserve the public values inherent in public institutions and to shift policy and managerial discretion back from the outsourcing vendors to government managers.

### *Measures of Effectiveness*

For each of the above goals, there will be a specific set of performance measures that will indicate the success of a chosen policy alternative toward accomplishing a goal. The first goal, minimizing the impact of outsourcing on the U.S. economy, can be measured through Bureau of Labor statistics and the amount of corporate investment in outsourcing services. Specifically, the most relevant statistics are the number of new jobs

created, the median wage of the new jobs, the number of jobs lost to outsourcing, and the national gross domestic product of the U.S. versus other countries.

Measuring the performance of the second goal is based on how well the standard of living and working conditions are improving for the employees of outsourcing vendors. Arnold and Bowie (2003) base their analysis of outsourcing on Kantian ethics in that corporations are composed of moral people (p. 226) and thus, corporations have an obligation to alleviate the lot of the poor (p. 226) and are uniquely situated to help the poor (p. 227). To determine if this obligation is being met, the standard of living for outsourcing vendor employees should rise to the level of a livable wage while workplace conditions should drastically improve in the terms of safety, working hours, and benefits.

The third goal will be the most difficult to measure as it involves the preservation of public values. As Peled (2001) argues, government managers are forced to outsource based on four reasons: inability to keep up with technology (p. 501), inability to separate planning from execution (p. 502), inability to measure the success of information technology projects (p. 502), and the inability to hire the best technical employees (p. 503). Therefore, public managers are forced to turn to outsourcing and so consultants capture more and more of managerial discretion (p. 507). Therefore, measuring how technically-savvy managers have become, the rise in salaries for government technology workers, and the drop in government outsourcing contracts will indicate that managers are able to overcome Peled's four reasons and thus managerial discretion should shift back toward the government managers.

## Policy Alternatives

### *Description of Alternatives*

There are a number of policy actions that address the issue of outsourcing ranging from taking no legislative action and relying on market mechanisms to a complete ban on outsourcing. Before considering the various policy alternatives, it would be beneficial to examine current best practices in outsourcing.

Barthelemy and Adsit (2003) describe seven common mistakes when companies outsource: "outsourcing activities that should not be outsourced" (p. 88); "selecting the wrong vendor" (p. 89); "writing a poor contract" (p. 90); "overlooking personnel issues" (p. 91); "losing control over outsourced activity" (p. 92); "overlooking the hidden costs of outsourcing" (p. 93); and "failing to plan an exit strategy" (p. 94). Any proposed policy should contain features that will prevent these common pitfalls of outsourcing.

Further examining the issue of selecting the proper vendor, Mirchandani and Liggett (2002) suggest the following criteria for choosing an outsourcing vendor that includes verifying their credentials and past records and having a compatible corporate culture (p. 18). Cohan (2003) adds that the company that outsources should establish a quality assurance department to ensure that the outsourcing vendor's services meet the company's standards (p. 54) and Flannery and Heckathorn (2003) add that building a solid business case for outsourcing ensures that the company fully examines its reasons for outsourcing (p. 11; see also Downing, Field, & Ritzman, 2003).

Outsourcing experts also caution against choosing vendors solely on cost and encourage companies to build relationships with their vendors. Companies are encouraged to transform their business processes (Agrawal, Farrell, & Remes, 2003,

p. 24), spend more time on building good employment practices with both in-house and outsourced employees (Drucker, 2002, p. 77), and ensure that they build quality into their outsourcing contracts (Millman, 2003, p. 55). Even though these new practices will add 5% to 7% percent in additional management costs (Bielski, 2003, p. 80), forging closer relationships with outsourcing vendors will help avoid the seven mistakes Barthelemy and Adsit identify. Tomback (2003) also encourages companies to consider cosourcing, keeping many processes while outsourcing high-risk processes (p. 14), thereby forging an extremely close relationship with their vendor.

In cases involving outsourcing public services, decision makers should consider political factors and economic factors that will be viewed favorably by the public (Nicholson-Crotty, 2004, p.43). As studies indicate, there is a multistage approach to outsourcing and "different motivations may predominate at different stages of the process" (p. 44). Citizens and elected officials are more likely to champion outsourcing and focus on the political motivations behind outsourcing decisions (p. 44) whereas administrators emphasize "instrumental concerns such as cost, efficiency, and effectiveness to a greater degree" (p. 44).

Thus having examined the current best practices in outsourcing, effective policy alternatives can now be formulated. The first alternative, "Market," would be no governmental action thus letting the business community police itself. The second alternative, "Incentive," is a series of tax incentives for companies that help create high-paying jobs to replace jobs that have been outsourced and that provide a livable wage and safe working conditions for their outsourced employees. The third alternative, "Requirement" is requiring companies to create jobs that have been outsourced and to

provide livable wages and safe working conditions for their outsourced employees. The fourth alternative, "Restrict," is restricting the amount and type of jobs that can be outsourced. The fifth alternative, "Ban," is a total ban on outsourcing of any American jobs to a foreign country.

In any case, the government should ban the outsourcing of public services and devote resources to training government managers in effectively dealing with information technology. This is necessary in order to preserve public values and to prevent conflicts of interest in enforcing outsourcing regulations.

#### *Comparison of Future Consequences*

The Market alternative is essentially a continuation of the status quo and allows the policy maker to verify that the projected job losses and economic disruptions of outsourcing opponents will occur. As it stands now, the economic costs of outsourcing are still a small part of the U.S. economy and any legislative action against outsourcing may have undesired effects. Outsourcing advocates would argue that there are more pressing issues affecting the economy that should be addressed first before considering the issue of outsourcing.

The Restrict alternative also relies on market mechanisms to handle the outsourcing issue but provides a safety zone in that it restricts the potential negative effects to certain industries and jobs. Thus, if the projections do not come true, then no harm has been done whereas, if the projections are true, the damage has been limited to a manageable portion of the U.S. economy.

The Incentive and Requirement alternatives have the same goals but use different means in achieving the goals. Incentive gives the companies a choice but overrides the purely market mechanism by making it more beneficial for the companies to aid in protecting the U.S. economy and foreign workers. The Requirement alternative is strictly regulatory and imposes U.S. economy protection and foreign worker protection as the cost of doing business.

The Ban alternative takes the decision to outsource completely away from the business community without regard to market mechanism. This approach is the most restrictive and assumes that the worst-case projections are correct.

#### *Spillovers and Externalities*

The positive externalities from the Incentive, Requirement, Restrict, and Ban alternatives is that there will be a greater focus on U.S. job creation and more awareness of the plight of foreign workers. Additionally, if the projections by the opponents of outsourcing bode true, then the U.S. economy will be in better shape than if the Market alternative was chosen. Negative externalities may result from a corruption of the market mechanisms that have made the U.S. economy robust and thus cause greater economic disruption than would have been realized by outsourcing itself.

The positive externalities that arise from the Market alternative are a conservation of regulatory resources and allowing U.S. business to be innovative in developing self-policing mechanisms that are market-friendly. If the projections of the opponents of outsourcing turn out to be false, then choosing the Market alternative might have prevented wasted resources on a policy problem that never materialized. The negative

externalities is that the projections come true and the business community exacerbates damage to the U.S. economy through a failure to find ways to mitigate the damage. In addition, relations between the U.S. and foreign companies will suffer if the U.S. is perceived as unfairly taking advantage of developing countries.

In all the alternatives save Ban, there are the negative externalities arising from the hidden costs of outsourcing. As Garaventa and Tellefsen (2001) argue in their article, American corporations may lose their competitive edge by relying on "mercenary workers" (p. 31) instead of "renew[ing] their ethical commitment to their employees, and create a workplace characterized by mutual respect and loyalty" (p. 31)

The complete ban on outsourcing public services will require greater resources at first to adequately train government managers and there will be major inefficiencies in the short term as the public agencies adjust to the new practices.

### *Constraints and Political Feasibility*

#### *Constraints*

The Incentive, Requirement, Restrict, and Ban alternatives will require varying amounts of regulatory resources to ensure that the companies comply with regulations that will govern how companies may outsource. The Incentive will require the most money in the form of lost tax revenue and the verification that the companies are truthful in filing their tax forms to receive the benefits. Requirement, Restrict, and Ban will avoid the problem of lost tax revenues but will have greater budgets to verify compliance with outsourcing regulations.

Market will also incur costs as the government will suffer lost tax revenue from laid-off workers and greater costs in training and providing benefits to displaced workers. Thus, there will be budget constraints in case projections prove true and the numbers of unemployed grow.

### *Political feasibility*

Any move toward regulation of outsourcing will be met with fierce and well-organized resistance from that part of the business community that benefits from outsourcing. But, if unemployment due to outsourcing grows, the policy maker will face increasing pressure from the American public to regulate outsourcing. Thus, any actions at first will be challenged by the business community and thus, action will be delayed until the pressure from the American public overwhelms the pressure from the business community. Either way, the policy maker will be criticized for taking action too soon or too late.

Focusing on the treatment of foreign workers, the American government and the business community may also face pressure international non-governmental organizations (NGO) devoted to human rights. NGOs are "non-profit groups that combine resource mobilization, information provision, and activism to advocate for changes in certain issue areas" (Spar & La Mure, 2003, p. 79) and play an increasingly-powerful role in influencing corporate behavior (p. 81). So, if the American government fails to respond in a timely fashion, pressure from NGOs may constrain its policy choices

as world attention is focused on the mistreatment of employees of the outsourcing vendors.

## Policy Recommendations

### *Criteria for Recommending Alternatives*

Given that the full effects of outsourcing are still yet to be realized, an overriding criterion for any policy alternative is to allow the U.S. economy to function effectively with a minimum of interference. Thus, American jobs should be protected but not at the expense of constraining businesses from seeking the best ways to maximize their profits. Additionally, any proposed solution must prevent the abuse and exploitation of foreign workers. Then, the alternative should be adjustable so that it can compensate for complexities of the economic cycle.

Finally, each alternative should be examined to determine its acceptability to both the American business community and American public. An important secondary consideration is the regulatory cost of ensuring compliance. Of course the less expensive governmental action is preferred.

### *Description of Preferred Alternatives*

Based on the above criteria, the preferred alternatives are Incentive and Requirement. Incentive has a minimum of interference while encouraging companies to be good corporate citizens and indicating to the American public that action is being taken on the outsourcing issue. Incentive is also scalable and tax benefits can be easily

adjusted to compensate for variations in the economic cycle. Incentive also helps address the issue of foreign workers while keeping regulatory costs low.

Requirement will face more resistance from the business community but will also be supported the American public so that the political pressure will most likely be balanced. Requirement is also scalable but not as quickly as Incentive due to rulemaking progress of administrative agencies. Regulatory costs will be higher as more resources will be needed to ensure compliance by a more adversarial business community. There may be greater regulatory costs due to foreign worker requirements.

#### *Outline for Implementation Strategy*

It is suggested that policy makers start with the Incentive alternative because it is the most business-friendly and costs the less in regulatory resources. The government should start by educating the American business community and the American public on the issues of responsible outsourcing and encourage best practices in ethical outsourcing. The tax incentives should be structured so that they serve as additional education on practicing good, ethical outsourcing. Then, the U.S. government should work with NGOs and the governments of the countries where outsourcing is prevalent so as to ensure that foreign workers are treated well by companies receiving the tax incentives.

The advantage of starting off with the Incentive alternative is that if it becomes necessary to take more immediate action, decision makers can switch to the Requirement alternative. This will of course engender more resistance from the business community but may be necessary if the projections hold true and the American public demands more action on outsourcing. And switching to the Requirement alternative will also require an

increase in regulatory resources as it will become necessary for the government to enforce against the entire business community instead of the smaller number companies that submit to voluntary enforcement under the Incentive alternative.

#### *Provisions for Monitoring and Evaluation*

Under the Incentive alternative, the primary agency responsible for monitoring and evaluation will be the Internal Revenue Service. The Requirement alternative may require a separate agency or coordination between the Internal Revenue Service and the Department of Labor to ensure that the businesses will comply with the outsourcing regulations. The Department of State may also be involved to coordinate oversight of the foreign workers treatment requirements.

#### *Limitations and Unanticipated Consequences*

The biggest limitation is convincing the American business community and the American public that action is necessary because the debate over outsourcing is still far from settled as to whether it has a significant economic impact. Once the need for action is established, policy makers should expect major resistance from the business community on any type of regulation concerning outsourcing. Tax incentives may be more popular but, if not enough companies take advantage of them, the Requirement alternative may still be enacted.

In any regulations involving the economy, there are always unintended consequences in altering the nature of supply and demand. Again, the cure for job losses due to outsourcing may even lead to greater job losses as companies suffer from higher

labor costs when they are prevented from outsourcing. Another unintended consequence may result from foreign governments that feel the U.S. is usurping their authority by monitoring the conditions and pay of foreign workers.

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