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75 East Northfield Road/ Livingston, NJ 07039 / 973−992−6600

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HEADLINE: FT REPORT − THE WORLD 2006: Movement of tasks overseas jumps up skills chain relentlessly OFFSHORING: Developed nations such as the US and the UK are being forced to look at their attractiveness, says David Wighton

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By DAVID WIGHTON

NEW YORK

In the space of a few days last month, three of the biggest companies in the US − JPMorgan Chase, Intel and Microsoft − announced plans to create a total of more than 7,500 jobs in high−value areas such as research and development, and processing complex derivatives trades.

But for those worried about sluggish job creation by the US economy there was a snag. The jobs would all be in India. Worse, they would be jobs that in the past would have been in the US.

The announcements highlighted both the rapid growth and the changing pattern of "offshoring". What started with manufacturing jobs and moved to call−centre staff has spread to highly skilled white−collar posts.

For some big US companies, what began as an interesting experiment has become a core strategy. Under JPMorgan's plans, 20 per cent of the global workforce of its investment bank will be in India by the end of next year.

"The speed of this transformation is what's so daunting," said Stephen Roach, Morgan Stanley's chief economist in a recent research note.

Critics argue that companies moving aggressively offshore are storing up trouble for themselves and their home economies. Some claim that the problems encountered by a few early attempts show that the benefits have been overstated and predict that the fad will soon peak.

But, judging by the public and private plans of many large US companies, this is wishful thinking. Most mainstream observers believe the trend will benefit more people than it hurts on both sides.

According to the McKinsey Global Institute, the number of offshore service workers will jump from the current 1.5m to 4.1m by 2008. US and UK companies have led the way − accounting for more than three−quarters of offshore staff − with continental Europe tending to be more cautious, not least because of domestic political pressures. But, in spite of a recent survey showing that French companies are increasingly sceptical about the benefits of offshoring, McKinsey expects non US and UK companies to account for more than half of offshore staff by 2008.

Several US states have passed laws restricting offshoring of state contracts, with more expected. "At the state level, these efforts will continue," says Stuart Anderson, director of the National Foundation for American Policy.

At the moment, these moves are little more than symbolic but they show the effectiveness of lobbying by labour and other groups.

Campaigners claim heavyweight backing from Paul Samuelson, the Nobel prize−winning economist, who wrote a paper in 2004 explaining that, in certain circumstances, free trade could leave rich countries worse off.

As a matter of empirical fact, this is unlikely to be the case, say many other economists such as Columbia University's Jagdish Bhagwati.

But Mr Roach says the facts are all too plain. The low job growth and stagnant wages generated by the US economy in recent years are the result of what he calls "powerful cross−border labour arbitrage". This is putting "extraordinary pressure" on the incomes of one of the global economy's main engines, the American consumer. "The internet is living up to its reputation of being the most disruptive technology in the history of the world."

According to Diana Farrell, director of the McKinsey Global Institute, such fears are overblown. She says far fewer jobs can be performed remotely than is assumed. In part, this is because one−third of US workers are employed by companies with fewer than 100 employees − too small to justify offshoring. "Even larger companies find offshoring is more complex than they expect," says Ms Farrell in a recent report.

As a result she concludes that no more than "several hundred thousand jobs per year will be lost to offshoring". Because this is small relative to the US labour force, the impact of offshoring on wage levels "will also be negligible".

This, of course, is little consolation for those who lose their jobs. As Thomas Friedman points out in The World is Flat: "When you lose your job, the unemployment rate is not 5.2 per cent; it's 100 per cent."

But rather than fight to preserve existing jobs, some labour unions are trying to look forward. In August, Computer Sciences Corporation, one of the world's largest IT services providers, agreed with Amicus, a UK union, to plough back some of its savings from moving tasks offshore into retraining those whose jobs are threatened. Other such deals have been reached with UK financial services companies including Barclays and Lloyds TSB.

Some opponents of offshoring hope companies will be deterred by the failures. Certainly there have been disappointments − particularly in customer services − although often these have been to do with outsourcing (contracting out services to a third party) rather than to offshoring.

But many large companies are delighted with the results. For JPMorgan, the attractions of India are not just costs − which industry analysts estimate at about 40 per cent below US levels − but also the calibre of staff being produced by Indian universities. "The quality of the people we hire is extraordinary and their level of loyalty to the company unbeatable," says Veronique Weill, head of operations at JPMorgan's investment bank.

To avoid being too concentrated in one country, JPMorgan is already looking at other potential offshoring locations mainly in eastern Europe, but also China and the Philippines.

For European−based companies, eastern Europe has the advantage of proximity as does Latin America for the US. Both regions are starting to see strong growth in so−called "near−shoring" jobs.

Sakonnet Technology, a New York company that builds energy trading software, opened a development centre in Rio de Janeiro a year ago where it now has one−third of its staff. Thurstan Bannister, chief executive, says Rio has a deep pool of software engineering talent. "And the time zone allows our people there to talk through the day to colleagues in New York and London."

Yet the biggest beneficiaries of offshoring investment from foreign companies are not Latin America, China or even India. They are the US and the UK. McKinsey's Ms Farrell says that rather than trying to prevent jobs moving offshore, US lawmakers should concentrate on improving the attractiveness of the US to inward investors by tackling weak telecommunications infrastructure and rising health costs.

"US policymakers cannot avoid addressing both of these issues if the country is to continue being a magnet for foreign investment."

David Wighton is the FT's New York Bureau Chief.

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