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ANTI-OUTSOURCING EFFORTS DOWN BUT NOT OUT

While anti-outsourcing efforts at the state and federal level have diminished from their height of a few years ago, legislative action to restrict global sourcing continues. This NFAP Policy Brief examines what has happened to date in the offshore outsourcing debate, including a look at legislation in 2007, and analyzes the future course of anti-outsourcing activity.

A STORM RISES

In a speech given during his 2004 Presidential campaign, Senator John Kerry (D-MA) famously declared, "When I am President, and with your help, we're going to repeal every benefit, every loophole, every reward that entices any Benedict Arnold company or CEO to take the money and the jobs overseas and stick the American people with the bill."[1]

American corporate executives did not like being compared to Benedict Arnold. Dave Sikora, CEO of Pervasive Software, responded to Kerry's statement with an opinion article in the *Wall Street Journal* (May 1, 2004): "And how is it that I am a traitor?" Sikora wrote. "This is the country that I would die for, if asked. It's also the country that benefits from the economic production that occurred in my 22-year career in the information technology industry, where I have created hundreds of jobs and hundreds of millions of dollars in shareholder wealth." Sikora explained that his company started building software products in India for a logical reason: "The supply of talented computer software engineers created favorable economic conditions to build products at terrific prices, with the same reliability and high standards. These cost savings will mostly be redeployed into top-drawer American jobs – highly paid professional positions to handle the increased production capacity."[2]

The Dave Sikora-John Kerry debate on offshore outsourcing served as only one chapter in the battle over global sourcing. Since 2003, CNN's Lou Dobbs has devoted a significant amount of time on his nightly one-hour program to reports, debate, and criticism of international trade. In 2004, he published a book called *Exporting America*, named after the regular segment on his show attacking outsourcing. Opponents of outsourcing use the term to describe nearly any activity that involves importing goods and services that could have been produced in the United States, particularly imported manufactured goods from China and imported services from India, such as information technology and call centers.

"The power of big business over our national life has never been greater. Never have there been fewer business leaders willing to commit to the national interest over selfish interest, to the good of the country over that of the companies they lead," is how Lou Dobbs begins his book. "And the indifference of those business leaders to our long-term national welfare is nowhere more evident than in the exporting of American jobs to cheap overseas labor market."[3]

Although the most high-profile critic, Lou Dobbs is not alone in attacking global sourcing. By 2005, more than 80 anti-outsourcing web sites had established themselves, most questioning the patriotism of companies and executives that hire employees or maintain facilities outside the United States. “It’s odd to push the loyalty argument at a time when the world is more interdependent than it’s ever been,” said Charles K. Rowley, Professor of Economics at George Mason University. Today, there are many sources for a particular product, so it’s unlikely that any country could withhold resources successfully from U.S. buyers.” Rowley questions the definition of loyalty used by critics of trade and outsourcing. “It’s loyalty to a particular group. Is it loyalty to Americans? No, it can’t be, because Americans gain. You and I gain whenever a cheap Toyota car comes over here and lowers the price of autos,” he said. He believes the specter of loyalty is being used by workers and others as a way to justify support for less competition in their industries. “Is loyalty just another word used for joblessness? If that’s the case then it’s loyalty to a special interest, it’s not loyalty to the nation. Because with comparative advantage you’re better off as a country when people trade.”[4]

There is little denying that politics and self-interest have played a role in anti-outsourcing initiatives. Motivation always exists for one political party, candidate or elected official to seek advantage on an issue. However, it would be wrong to associate all anti-outsourcing activity with politics alone. Globalization entails costs, benefits, and change – and change attracts opponents. Most importantly, in any dynamic economy there will be individuals displaced either temporarily or long-term. This leads such individuals to speak out or inspires others to do so on their behalf. One group with an interest in speaking out is elected officials.

STATE LEGISLATION: 2003-2004

When the National Foundation for America Policy released its first study on global sourcing in December 2003, bills had been introduced in only four states – North Carolina, Indiana, New Jersey and Michigan.[5] Just five months later, when NFAP released its second study, the number had grown to over 100. By the end of 2004, state legislators had introduced more than 200 such bills in more than 40 states.

None of the anti-outsourcing bills introduced in 2003 became law that year. However, five state bills became law in 2004 – in Alabama, Colorado, Indiana, North Carolina and Tennessee:

- **Alabama** - Senate Joint Resolution 63 (public law 2004-234; introduced April 8, 2004). A resolution that encouraged state and local entities to use Alabama-based professional services but does not restrict or place mandates on procurement decisions.

- **Colorado** – H.B. 1373 (signed by Governor June 4, 2004). The bill stated agencies can contract for personal services performed outside the United States if it is clearly demonstrated that there will be no reduction in the quality of services offered and contracts contain confidentiality and right to privacy safeguards.

- **Indiana** – H.B. 1080 (signed by Governor 3/17/04). The law provides price preferences between 1 and 5% for Indiana companies in awarding state contracts.

- **North Carolina** – H.B. 1414 (signed by Governor July 21, 2004). The law mandates a preference for North Carolina or U.S. products and services within bounds of federal law "provided, however, that in giving such preference no sacrifice or loss in price or quality shall be permitted."

- **Tennessee** – S.B. 2344 (signed by Governor 5/10/04). The law requires the commissioner of finance and administration to authorize, through regulation, "a preference in the evaluation of proposals for state contracts requiring the performance of data entry and/or call center services for vendors for whom such services will be solely provided by citizens of the United States who reside within the United States."

Governors vetoed bills in three states in 2004. In California, on September 30, 2004, Governor Arnold Schwarzenegger vetoed 5 bills: S.B. 888 (state contract ban on homeland security-related work offshore), S.B 1451 (prohibits sharing of privacy information in violation of CA law), A.B. 1829 (state contract ban on overseas work), A.B. 2715 (disclose location of call center upon request), and A.B. 3021 (report location of employees and hired contractors).

In announcing his veto of one of the bills, Governor Schwarzenegger stated, "There is a right way and a wrong way to expand economic opportunity in California. The wrong approach is to implement measures that restrict trade, invite retaliation or violate the United States Constitution or our foreign trade agreements."[6] This statement mirrored the National Foundation for American Policy's analysis regarding the Constitutionality of state anti-outsourcing legislation.[7]

In Maryland, on May 25, 2004, Governor Robert Ehrlich vetoed H.B. 183, which would have allowed consideration of whether work would be performed outside the United States in awarding state contracts. In Massachusetts, on June 25, 2004, Governor Mitt Romney vetoed Section 21 of H.B. 4850. The section would have prohibited services of a privatization contract from being performed outside United States.

Governors also issued executive orders on global sourcing in 2004 in Alaska, Florida, Michigan, Minnesota, Missouri and New Jersey. Procurement policy memos were issued in Arizona (April 9, 2004) and Ohio (June 1, 2004).[8] North Carolina's governor issued an executive order in August 2003.

State Legislation: 2005

Although many expected after the 2004 elections that global sourcing would go away as an issue, such an assessment proved incorrect. Over the course of the 2005-06 sessions, 190 bills were introduced in state legislatures to restrict or report on global sourcing, according the Economic Growth and American Jobs Coalition.[9] In 2005, 7 bills became law that restricted global sourcing in some manner, while three more laws were passed that established commissions or studies.

The bills were:

- **California** – A.B. 1741 prohibits voter information from being sent outside the United States. Signed by Governor on July 25, 2005.
- **Colorado** – H.B. 1307 provides an in-state preference for agricultural products and prohibits Governor from binding state on future trade agreements. Signed by Governor on June 7, 2005.
- **Illinois** – S. 1723 provides a preference of items manufactured in the United States for procurement purposes. Signed by Governor on August 10, 2005.
- **Maine** – L.D. 47 requires "the necessity of collecting information on the State's contracting and outsourcing practices." Signed by Governor May 12, 2005.
- **Maryland** – H.B. 514 prohibits Governor from binding state on future trade agreements. Legislature voted to override Governor's veto of bill on April 11, 2005.
- **New Jersey** – S. 494 prohibits state contract work from being performed outside the United States. Signed by Governor on May 5, 2005*. Note: This law represents the most restrictive anti-outsourcing legislation in the nation.*
- **New Jersey** – A.R. 184 The resolution creates the "Outsourcing and Offshoring Commission" to, among other things, "study ways to reduce outsourcing and off-shoring in the State." Resolution adopted July 6, 2005.
- **North Carolina** – H.B. 800 requires a vendor submitting a bid to disclose "where services will be performed under the contract," including performance outside the United States. Signed by Governor July 7, 2005.
- **North Dakota** – H. 1091 provides an in-state preference on equal bids on state contracts. Signed by Governor on March 30, 2005.

- **Washington** – C.R. 8407 establishes a far-reaching joint task force for the study of offshore outsourcing. Adopted on April 24, 2005.

By far the most restrictive anti-outsourcing law in the nation remains New Jersey's S. 494, which prohibits state contract work from being performed outside the United States. An NFAP legal analysis concluded that such legislation is likely unconstitutional. A primary reason that businesses have not yet challenged the law in court is that the state interpreted the legislation to contain a grandfather clause that permitted offshore work to continue on existing state contracts. (See later discussion in this analysis on Constitutionality of the anti-outsourcing measures.)

In 2005, the Governor of Indiana issued an executive order establishing a "Buy Indiana" presumption. During 2005, Governor Schwarzenegger vetoed two more bills to restrict global sourcing (A.B. 524 and A.B. 1339) in California.

State Legislation: 2006 and 2007

In 2006, one could discern a reduction in state legislation to restrict global sourcing. Two bills became law and both focused on state commitments related to international trade agreements. Vermont H.B. 109 established a commission for conducting annual assessments on the impact of international trade pacts. Rhode Island H. 6885/S. 2331 states the General Assembly must enact legislation to explicitly authorize the governor to commit the state's procurement rules to be bound by a particular international trade agreement. The Governor of Colorado vetoed legislation (H.B. 1010) similar to the bill that passed in Rhode Island.

In 2007, as of April 10, 2007, a total of 41 bills had been introduced at the state level to restrict global sourcing.[10] To date none of the bills have become law. However, one can see continued legislative activity among state legislators who have introduced bills in the past. Connecticut, Minnesota, Oklahoma, Arizona, New York, Hawaii and California remain among the most active states with bills introduced to restrict state services, call center operations or state involvement in international trade agreements.

At present, the two anti-outsourcing bills with the best chance of becoming law are H.B. 1127 in Indiana, which would restrict sending certain medical-related information outside the United States, and H.B. 4100 in Michigan, which includes a provision for a report on any goods or services purchased by the state in the past fiscal year from outside the United States. The Indiana bill passed the House (February 20, 2007) and the Michigan legislation passed its House (March 22, 2007) as well. The Indiana legislation would require a health plan to obtain "an annual, written consent from the individual for the individually identifiable health information to be transmitted to a location outside the United States."[11]

States with bills to restrict or prohibit government agencies from purchasing goods or services from outside the United States include Arizona (H.B. 2420, H.B. 2421 and H.B. 2614), Colorado (S.B. 228) Connecticut (H.B. 1278, H.B. 5323, H.B. 5441, H.B. 7032 and H.B. 7147), Hawaii (H.B. 32), Illinois (H.B. 568 and S.B. 1255), Michigan (H.B. 4100) Missouri (H.B. 692), Nebraska (L.B. 87), New Hampshire (H.B. 129, H.B. 833), New York (A.B. 645), Oregon (H.B. 2831 and H.B. 2903), Pennsylvania (H.B. 389, H.B. 390 and H.B. 391), Vermont (H.B. 272) and Virginia (H.B. 1719 and S.B. 861).

States with bills that would restrict call center operations include Georgia (S.B. 214), Massachusetts (H.B. 3341), Minnesota (H.F. 116 and S.F. 162), Nevada (A.B. 422), North Carolina (S.B. 514), Oklahoma (H.B. 1292 and H.B. 1533), Oregon (H.B. 2836) and West Virginia (H.B. 2296).

States that introduced legislation to restrict state officials or the federal government from binding the state to government procurement rules in an international trade agreement include Alabama (H.B. 454), Arizona (H.B. 2420), Hawaii (H.B. 30 and H.B. 31), Minnesota (H.F. 1199 and S.F. 973), Nevada (A.B. 470), New York (A.B. 3321) and Oregon (H.B. 3340). States also have set up various advisory bodies to monitor federal trade activity or express displeasure with the Fast Track Authority or the World Trade Organization: Georgia (S.R. 124), Hawaii (S.C.R. 109), Massachusetts (H.B. 374), Michigan (S.B. 353), Minnesota (S.F. 2060), Nevada (A.J.R. 10), New Hampshire (S.B. 162), New York (A.B. 993) and Tennessee (H.B. 596).

Constitutional Issues

Many state efforts to restrict global sourcing are likely unconstitutional or violate trade agreements. A legal analysis for the National Foundation for American Policy performed by Shannon Klinger and Lynn Sykes, attorneys with Alston & Bird, concluded that state contract bans "are legally suspect ... since courts would likely find that such measures improperly intrude on the federal foreign affairs power and violate the U.S. Constitution's foreign commerce clause."[12] Simply put, states are not allowed to make their own trade or foreign policies.

These constitutional concerns are of particular importance when state actions are likely to violate America's international trade obligations and thereby increase the likelihood of trade retaliation from foreign countries. The United States, along with more than 30 other nations, has signed the Government Procurement Agreement, which prohibits state and federal procurement policies from discriminating on the basis of where work would be performed.

A more detailed discussion of the legal issues surrounding global sourcing can be found in the NFAP legal analysis "Exporting the Law," which is available at www.nfap.com.

PRIVACY

In 2005-2006 legislative sessions, legislators introduced bills in 13 states to restrict sending personal data overseas. In California, a bill became law that prohibits sending voter data collected in referendums or initiatives outside the United States. That is getting close to the type of legislation that would restrict the sending of other forms of data outside the country. U.S. companies agree that it will only take one state to pass legislation to restrict the sending of personal data abroad to throw existing business activity into turmoil. Bills at the federal level to restrict the sending of data outside the United States were introduced in the last Congress.

One irony of these bills is that the federal government itself has been the most-publicized poor custodian of individual records, with reports of lost laptops and possible compromised data at the Internal Revenue Service, U.S. Department of Commerce, U.S. Department of Veterans Affairs and other federal agencies.[13]

As both leading consumers and providers of financial services, Americans benefit from keeping information flowing freely across international boundaries. Like other forms of international cooperation, allowing data to move freely lowers prices for consumers and allows American companies to compete effectively in the global market. Forcing U.S. companies to obtain prior consent individually from tens of millions of people before information could be sent outside the United States is considered unduly burdensome from a business perspective. While the European Union requires affirmative consent and such a heavily regulatory structure is problematic, enforcement is limited in Europe on this measure and the trial bar is also far weaker in the EU than in the United States.

No evidence exists that sending information outside the United States presents great dangers. An executive with a transcription firm notes that in India their firm maintains a secure office environment that prevents, among other things, copying data from company servers. In contrast, transcribers and call operators in the United States may work at home on the same computer used by their husband and other family members.

None of this means countries like India or the Philippines are immune to bad actors anymore than is the United States. There have been cases of data misused and criminal prosecution in India. As part of an effort to address this, Indian high tech companies have pooled together to create an employee database that can be used to screen out individuals with questionable backgrounds. There does not appear to be a comparable effort to date in the United States, though U.S. firms have adopted a number of measures aimed at improving data security and privacy.

The market provides an incentive for a foreign company to take great care in protecting private consumer information, since failure to do so would likely end that firm's chance of gaining any future contracts, jeopardizing the company's very existence. Legal experts say the Federal Trade Commission warns American companies that liability remains when data goes overseas – those who send it there are responsible for its security and the overseas custodian is essentially an agent of the U.S. company.

Existing federal laws, including the Fair Credit Reporting Act, the Health Insurance Portability and Accountability Act, and the Gramm-Leach-Bliley Act, already address the treatment of certain consumer information and permit the sharing of consumer information among affiliated entities overseas, while providing mechanisms for recourse against U.S. corporations for failing to take appropriate measures to guard consumer information.

If additional safeguards are needed the best approach would be to engage in multilateral negotiations with several countries to adopt a common privacy standard or work with other nations to strengthen their laws. Either tactic would be better than adopting a unilateral approach designed to erect trade barriers, not protect consumers.

FEDERAL EFFORTS TO RESTRICT GLOBAL SOURCING

At the federal level, the biggest threats will remain amendments to other federal legislation. In 2004, the U.S. Senate passed by a vote of 70-26 an amendment by Senator Christopher Dodd (D-CT) that would have banned, with some exceptions, the use of any federal funds (including federal grants) for work to be performed offshore. This would have extended and made permanent a similar temporary prohibition passed in an appropriations bill called the Thomas-Voinovich amendment. A House-Senate conference later dropped the 2004 amendment by Senator Dodd.[14]

In the 2005-2006 Congressional session, Senator Hillary Clinton (D-NY) authored the Safeguarding Americans From Exporting Identification Data Act' or `SAFE-ID Act' (S. 800). Senator Clinton's bill would have prohibited the disclosure of "personally identifiable information regarding a resident of the United States to any foreign branch, affiliate, subcontractor, or unaffiliated third party located in a foreign country unless" a series of standards are met, including allowing consumers to prevent the sending of such data. An irony of Senator Clinton championing such restrictions is that New York is home to America's leading financial institutions and such legislation would uniquely harm these firms. Senator Bill Nelson (D-FL) proposed a similar measure in 2004.

In the House, Rep. Edward Markey (D-MA) authored the companion measure to S. 800, while Rep. Cliff Stearns (R-FL) authored H.R. 1263, which would also push for potential restrictions and increased regulation on sending data outside the United States. One can anticipate similar efforts by legislators to emerge in the 2007-2008 Congressional session.

CONCLUSION: THE JOBS DEBATE

While the debate over global sourcing has centered on jobs, the effect of anti-outsourcing activity is often fiscal. At the most practical level, by limiting competition for state contract work, anti-outsourcing measures would increase procurement costs. This could be seen in 2002 after a contractor established a call center in India for New Jersey welfare and food stamp recipients. Criticism erupted the following year, and in response, the state negotiated a deal with the contractor to move the call center back to the United States. As a result, New Jersey taxpayers paid, on top of the original contract costs, an additional $886,000 for 12 jobs. "Saving" 1,400 such jobs in the future would cost the state an extra $100 million a year.

Evidence has emerged that concerns about outsourcing overseas as a source of job loss have been overstated in the media. A 2005 report from the Bureau of Labor Statistics indicates that in only 2 percent of recent layoffs of 50 or more people was offshore outsourcing even a factor.[15] While it is understandable that Americans are anxious about jobs, there is no evidence that trade protection saves jobs.

“Offshoring creates wealth for U.S. companies and consumers and therefore for the United States as a whole,” concluded a report by the McKinsey Global Institute. Global sourcing saves U.S. companies, on average, 58 cents for every dollar spent overseas, thereby increasing productivity, profitability and competitiveness. For every dollar spend offshoring, U.S. service providers purchase an additional five cents worth of U.S. goods and services, which create U.S. jobs. “Far from being bad for the United States, offshoring creates net additional value for the U.S. economy that did not exist before, a full 12-14 cents on every dollar offshored,” according to the McKinsey Global Institute.[16]

“While global software and IT service outsourcing displaces some IT workers, total employment in the United States increases as the benefits ripple through the economy,” according to the economic consulting firm Global Insight in a report released by the Information Technology Association of America. “The incremental economic activity that follows offshore IT outsourcing creates over 257,000 net new jobs in 2005 and is expected to create over 337,000 net new jobs by 2010.”[17]

Anti-Outsourcing Efforts Down But Not Out

A 2006 report by the Duke Center for International Business Education and Research and Booz Allen Hamilton found that the number of jobs lost onshore per offshore project has dropped by 70 percent since 2005….90 percent of all R&D offshore implementations created no job losses on shore." The report concluded, "In the near term, contrary to various claims, fears about loss of high-skill jobs in engineering and science are unfounded." The research found that "In effect, offshoring is no longer about moving low-paid jobs elsewhere; but about sourcing highly skilled talent everywhere. What used to be an exercise in tactical labor cost savings is not a strategic imperative of competing for talent globally."[18]

The Department of Labor projects growth of 100,000 jobs a year in computer and math science occupations between 2004 and 2014, the highest of any high-skill job category in the United States.[19]

Despite this economic evidence, the bottom line is that while efforts to restrict global sourcing have diminished from their height of 2004-2005, legislative action will likely continue.

END NOTES

[1] "'Benedict Arnold' CEOs," *The Wall Street Journal*, February 12, 2004.

[2] David Sikora, "Who's the Benedict Arnold?," *The Wall Street Journal*, May 11, 2004.

[3] Lou Dobbs, *Exporting America*, Warner Business Books, 2004.

[4] Interview with NFAP.

[5] Stuart Anderson, *Creeping Protectionism: An Analysis of State and Federal Global Sourcing Legislation*, National Foundation for American Policy, December 2003.

[6] Steve Lawrence, "Schwarzenegger vetoes bills to prevent outsourcing of jobs," Associated Press, September 29, 2004.

[7] Shannon Klinger and M. Lynn Sykes, *Exporting the Law: A Legal Analysis of State and Federal Outsourcing Legislation*, National Foundation for American Policy, April 2004; Stuart Anderson, "Dubious assault on 'outsourcing,'" *Orange County Register*, July 2, 2004.

[8] The text of the executive orders (but not the policy procurement memos) are available on the NFAP website at http://www.nfap.com/researchactivities/globalsourcing/execOrders.aspx.

[9] The coalition is managed, in part, by the Information Technology Association of America.

[10] Economic Growth and American Jobs Coalition.

[11] One can find the texts of the bills cited here by going to the respective state legislature websites. One website with links to most of the state websites is http://governing.com/govlinks/glurleg.htm.

[12] Shannon Klinger and M. Lynn Sykes. The report is available at http://www.nfap.com/researchactivities/studies/NFAPStudyExportingLaw_0404.pdf

[13] See, for example, "Stealing from the IRS," editorial, *The Washington Post*, April 8, 2007.

[14] See *Understanding the Dodd Amendment*, NFAP Policy Brief, National Foundation for American Policy, March 2004.

[15] Stuart Anderson, "Outsourcing Attacks Not Over," *National Review*, February 11, 2005.

[16] Offshoring: Is it a Win-Win Game? McKinsey Global Institute, San Francisco, August 2003.

[17] Global Insight, *The Comprehensive Impact of Offshore Software and IT Services Outsourcing on the U.S. Economy*, ITAA, 2005.

[18] Arie Y. Lewin and Vinay Couto, *Next Generation Offshoring, The Globalization of Innovation*, Duke University Fuqua School of Business and Booz Allen Hamilton, 2006.

[19] http://www.bls.gov/news.release/ecopro.t02.htm.

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Established in the Fall 2003, the National Foundation for American Policy (NFAP) is a 501(c)(3) non-profit, non-partisan public policy research organization based in Arlington, Virginia focusing on trade, immigration and related issues. The Advisory Board members include Columbia University economist Jagdish Bhagwati, Ohio University economist Richard Vedder and other prominent individuals. Over the past 24 months, NFAP's research has been written about in the *Wall Street Journal*, the *New York Times*, the *Washington Post*, and other major media outlets. The organization's reports can be found at www.nfap.com.