Backgrounder
Published by The Heritage Foundation
No. 1757
May 13, 2004

Myths and Realities: The False Crisis of Outsourcing

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The American economy is never at rest. New technologies and trade links have expanded America's economy for centuries, making historically impressive economic growth seem routine. A side effect of high growth expectations is hypersensitivity to the slightest downturn. Even the relatively mild 2001 recession brought with it the undying myths of failure, stagnation, and the internal contradictions of capitalism, all summarized in one word: outsourcing.

Outsourcing is a new variant of the timeless assertion that capitalism is good for capital (greedy businessmen) at the expense of labor (hard-working Americans). However, this rehash of liberal populism is not based on sound economics. As stated by University of Chicago professor Daniel W. Drezner, "[B]elieving that offshore outsourcing causes unemployment is the economic equivalent of believing that the sun revolves around the earth: intuitively compelling but clearly wrong."[1]

One can only hope that an examination of the facts will kill off the following myths before policymakers overreact.

Myth #1: America is losing jobs.

Fact: More Americans are employed than ever before.

The notion of anemic job growth during the recovery rests entirely on one measure of employment: total non-farm payroll employment. However, the U.S. Department of Labor's payroll survey has problems capturing a changing workforce[2] as well as a history of large revisions, which are announced months and

Talking Points

- Outsourcing represents less than 1 percent of gross job loss—an estimated 55,000 jobs per quarter, compared to average gross job gain of 8.11 million jobs per quarter.
- Outsourcing means efficiency. In 1997, President Clinton advocated outsourcing some government functions as a means to balance the budget. From a business perspective, efficient sourcing cuts costs, saves jobs, lowers prices, and fuels growth.
- Anti-outsourcing proposals in Congress and at least 36 states threaten businesses and, if passed, would erode U.S. competitiveness and destroy U.S. jobs.
- Rather than relying on protectionist measures, Congress should improve the competitiveness of the U.S. business environment by eliminating overly burdensome regulations, attacking frivolous lawsuits through tort reform, simplifying and flattening the tax code, and ensuring affordable and reliable energy supplies.

This paper, in its entirety, can be found at:
www.heritage.org/economy/bg1757.cfm

Produced by the Thomas A. Roe Institute for Economic Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, N.E.
Washington, DC 20002–4999
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even years after the initial data are released. While the payroll survey has a vast sample size, its sample quality remains a concern due to overcounts of job changers and miscounts of other workers.

Most labor measures show real gains over the past three years and even some record highs. Real earnings are up; the rate of unemployment is low; jobless claims are 10 percent below the 25-year average; and the household survey—the only direct employment survey of Americans—indicates that 2.2 million more Americans are employed now than were employed before the recession ended in November 2001. Never before have this many Americans—138.6 million to be exact—been employed.[3]

Myth #2: The low unemployment rate reflects a discouraged workforce.

Fact: Unemployment is dropping, despite a surging labor force.

The latest U.S. unemployment rate has fallen steadily over the past few months and is now 5.6 percent, below the average of 5.9 percent for 1959–2003 and well below the average rate of 6.3 percent between 1973 and 2003.[4] Moreover, the U.S. enjoys far better unemployment rates than other developed nations. The average 2003 unemployment rate was 7.1 percent for the 30 members of the Organization for Economic Cooperation and Development.[5] Recent 2004 data show that unemployment is 8 percent in the Euro area (9.6 percent in France and 10.3 percent in Germany) and 7.4 percent in Canada.[6]

The assertion that unemployment is low in the U.S. only because many discouraged workers have abandoned the labor force is incorrect. The unemployment rate that includes discouraged workers is 5.9 percent: only 0.3 percent higher than the official rate,[7] which is no higher than usual. In fact, the U.S. labor force has *grown* by millions since November 2001. In other words, the unemployment rate illustrates real gains because the ratio of unemployed Americans to the total labor force is declining, even though the size of the labor force is growing.[8]

Myth #3: Outsourcing will cause a net loss of 3.3 million jobs.

Fact: Outsourcing represents less than 1 percent of gross job turnover and brings net gains to the economy.

Over the past decade, America has lost an average of 7.71 million jobs every quarter.[9] The commonly cited Forrester Research prediction of jobs lost to outsourcing estimates that 3.3 million service jobs will be outsourced between 2000 and 2015—an average of 55,000 jobs outsourced per quarter.[10] According to these numbers, at worst, jobs lost to outsourcing represent only 0.71 percent of all jobs lost per quarter as part of normal turnover in the economy.

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1. Daniel W. Drezner, "The Outsourcing Bogeyman," *Foreign Affairs*, Vol. 83, No. 3 (May/June 2004), at *www.foreignaffairs.org/20040501faessay83301-p0/daniel-w-drezner/the-outsourcing-bogeyman.html*.
2. Tim Kane, Ph.D., "The Myth of a Jobless Recovery," Heritage Foundation *Executive Memorandum* No. 917, March 25, 2004, at *www.heritage.org/Research/Labor/em917.cfm*.
3. The four-month moving average of the U.S. employment level from the Labor Department's population-smoothed household survey reached a peak in March 2004, based on the latest data available from the Bureau of Labor Statistics, *Employment Situation Report*, April 2, 2004.
4. "Civilian Unemployment Rate, 1959–2003," Table B-42, in *Economic Report of the President*, transmitted to Congress February 2002, p. 334.
5. "Unemployment Rates: Commonly Used Definitions," Annex Table 14 in Organisation for Economic Cooperation and Development, *OECD Economic Outlook: Statistical Annex*, Vol. 2003/2, No. 74 (December 2003), p. 196.
6. "Output, Demand and Jobs," *The Economist*, March 27, 2004, at *www.economist.com*.
7. Tim Kane, Ph.D., "Will the Real Unemployment Rate Please Stand Up?" Heritage Foundation *WebMemo* No. 456, March 24, 2004, updated April 2, 2004, at *www.heritage.org/Research/Labor/wm456.cfm*.
8. Bureau of Labor Statistics, population-smoothed household survey.
9. U.S. Department of Labor, Business Employment Dynamics Data Series, 1992 to 2003.

Other consulting firms have jumped on the bandwagon, but the author of the original Forrester study "now says his numbers were hyped"[11] and expresses frustration that the issue has spun out of context. The context, of course, is the net positive impact of trade and technology. America has averaged gross gains of 8.11 million jobs per quarter over the past decade—an average net increase of 400,000 jobs every quarter, swamping the impact of outsourcing.[12]

The new interest in outsourcing is producing a wave of new research, and the overwhelming consensus vindicates the position espoused by Greg Mankiw, renowned Harvard economist and current chairman of the Council of Economic Advisers, that trade-induced labor flows are a net positive for the U.S. economy.

First, the gains of trade have been shown to vastly outweigh the costs, even when job dislocations are factored into account.

Second, the U.S. economy is going through a permanent structural change, so the labor force dislocations are more severe than during normal recessions, which means the productivity gains are higher as well. The data support the theory here, with the U.S. economy experiencing record high gains in productivity.

Finally, even net jobs are gained due to outsourcing, as emphasized by a recent Global Insight study:

> While global IT software and service outsourcing displaces some IT workers, total employment in the United States increases as the benefits ripple through the economy. The incremental economic activity that follows offshore IT outsourcing created over 90,000 net new jobs in 2003 and is expected to create 317,000 net new jobs in 2008.[13]

Myth #4: Free trade, free labor, and free capital harm the U.S. economy.

An underlying myth is that economic freedom is a "race to the bottom" in which American workers must accept lower wages and fewer benefits in order to compete with low-cost labor in other countries.

Fact: Economic freedom is necessary for economic growth, new jobs, and higher living standards.

Countries that embrace economic freedom—including freedom of trade, labor, and capital—experience stronger economic growth than those that seek to thwart the market through regulatory hurdles and policy restrictions. The *2004 Index of Economic Freedom* confirms a strong, positive relationship between economic freedom and per capita gross domestic product (GDP). Moreover, average GDP growth rates increase as a country's economic freedom score improves, as measured in the *Index*.[14]

In other words, policies that are antithetical to economic freedom, including trying to protect the jobs of a few workers from outsourcing, will inevitably retard economic growth and lead to fewer jobs in the future. Trade freedom is one aspect of economic freedom, of course, and the U.S. Trade Representative confirms that the benefits of free trade are staggering:

> Last year alone, hidden import taxes cost American consumers $18 billion. Duty-free trade would eliminate these hidden costs and lower prices for consumers. While this proposal would offer substantial benefits to all Americans, it would particularly help

10. Clare Ansberry, "Outsourcing Abroad Draws Debate at Home," *The Wall Street Journal*, July 14, 2003, p. A2. See also John C. McCarthy, "3.3 Million US Services Jobs to Go Offshore," Forester Research *Brief*, November 11, 2002, at *www.forrester.com/ER/Research/Brief/Excerpt/0,1317,15900,00.html*.

11. Jon E. Hilsenrath, "Behind Outsourcing Debate: Surprisingly Few Hard Numbers," *The Wall Street Journal*, April 12, 2004, p. A1.

12. U.S. Department of Labor, Business Employment Dynamics Data Series, 1992 to 2003.

13. Global Insight (USA), Inc., "The Comprehensive Impact of Offshore IT Software and Services Outsourcing on the U.S. Economy and the IT Industry," March 30, 2004, at *www.itaa.org/itserv/docs/execsumm.pdf*.

14. Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2004 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2004), p. 21.

> low-income families. A recent study by the Progressive Policy Institute found that cutting U.S. import taxes especially benefits single-parent, low-income families, who typically pay a higher proportion of their income on import taxes than other households. A University of Michigan study found that the U.S. economy would expand by $95 billion as a result of tariff-free trade—contributing to job-creation and higher wages.[15]

A case in point is America's experience with the North American Free Trade Agreement (NAFTA), which has been a net boon for the U.S. economy and American workers. Employment in the U.S. increased by 20 million jobs between 1993 and 2000. In the 10 years since NAFTA's enactment, real hourly compensation has increased by 14.7 percent, including a 14.4 percent increase in manufacturing wages.[16] Trade among the three NAFTA nations has more than doubled, helping to lower prices for all consumers.

While free trade can cause localized pain for a few workers, the overall gains are overwhelming. The myth of lower wages due to increased trade is wrong on theory and wrong on the facts.

Myth #5: A job outsourced is a job lost.

An underlying myth is that trade is a zero-sum game in which prices do not matter.

Fact: Outsourcing means efficiency.

In 1997, President Bill Clinton "advocated outsourcing as a major budget-balancing tool and the National Performance Review urged agencies to consider farming out common computing tasks wherever feasible."[17] Clinton was not calling for job losses; instead, he recognized that efficiency in government meant a lower burden on the taxpayer and that private firms can often provide a service at a lower cost with higher quality than the government can.

The larger point is that "outsourcing" was never about exporting jobs. Outsourcing, from a business perspective, simply means having a component sourced externally from the firm that sells the final product. This leaves the business free to focus its resources on their highest and best use, producing and selling its products or services.

For example, a typical American company needs office supplies, from pens to computers. Yet producing these materials within the company makes little sense. An economy in which each company produced from scratch all of its own office supplies, uniforms, food, and infrastructure would be extremely inefficient.

In recent years, the trend toward outsourcing was viewed correctly as a positive evolution of business practices toward nimbleness and flexibility. Old jobs can be outsourced domestically, or to foreign firms, but technology often replaces the old job, with machines replacing workers. This is like the automation of farm labor, which has been replaced largely by tractors and other agricultural equipment over the past two centuries.

The result of this drive toward efficiency is visible to all Americans in the form of lower prices and a higher standard of living. For example, computers and televisions today cost a fraction of their cost in 1980, thanks to a relentless process of efficiency-driven change.

Foreign outsourcing is undoubtedly taking place and may increase, but it goes hand in hand with higher wages, lower prices, higher profits, and enhanced U.S. competitiveness. Punishing firms that outsource would only erode standards of living by raising the prices Americans have to pay.

15. Office of the U.S. Trade Representative, "U.S. Proposes Tariff-Free World, WTO Proposal Would Eliminate Tariffs on Industrial and Consumer Goods by 2015," November 26, 2002, at *www.ustr.gov/releases/2002/11/02-112.htm*, and Edward Gresser, "Toughest on the Poor: Tariffs, Taxes, and the Single Mom," Progressive Policy Institute *Policy Report*, September 10, 2002, at *www.ppionline.org/ppi_ci.cfm?knlgAreaID=108&subsecid=900010&contentid=250828*.

16. Office of the U.S. Trade Representative, "NAFTA at Ten: A Success Story," December 2003, at *www.ustr.gov/regions/whemisphere/2003-12-08-nafta10-factsheet.pdf*.

17. Kevin Power, "Feds, Get Used to Outsourcing: OMB's McConnell Says Administration Is Bullish on Contracting Out IT Work," *Government Computer News*, June 16, 1997, at *www.gcn.com/archives/gcn/1997/june16/govbiz.htm*.

Myth #6: Outsourcing is a one-way street.

Fact: Outsourcing is a two-way street.

There are currently 6.4 million jobs in the U.S. in which the employer is a foreign company. The rate at which these "insourced" jobs are growing is faster that the rate at which jobs in general are being lost. According to the Organisation for International Investment (OFII), "Over the last 15 years, manufacturing 'insourced' jobs grew by 82%—at an annual rate of 5.5%; and manufacturing 'outsourced' jobs grew by 23 percent—at an annual rate of 1.5%."[18]

Moreover, insourced jobs are often higher paying than those that are outsourced—e.g., the 4,300 workers at the BMW factory in South Carolina and the more than 14,000 employed at Honda plants in Ohio. Senator Mitch McConnell (R–KY) brought these facts to the Senate floor on March 4, citing data from the OFII and pointing out that every state has thousands of insourced workers. Michigan has 244,200. Ohio has 242,200. Even Idaho has 13,900 insourced jobs.[19]

Indeed, the nature of economic development means that while some lower-paying jobs may move overseas, higher-paying jobs move in. A study by the Institute for International Economics (IIE) found that:

> [O]f the 12 IT occupations that earned more than $50,000 in 2002, 75 percent increased their employment from 1999 to 2002. IT jobs earning more than $50,000 expanded by 184,000 from 1999 to 2002, of which computer software engineers earning approximately $75,000 per year accounted for 115,000 jobs.[20]

The IIE also punctures the myth that white-collar jobs are fleeing American shores in droves:

> The majority of US jobs, projected by the most widely quoted industry report on the issue, to be lost in occupational categories threatened by offshore outsourcing pays less than the US average wage, suggesting that many of these jobs may face medium-term elimination through technological change, regardless of whether they are outsourced to offshore locations or not.
>
> Some IT occupations have declined, but the declines are concentrated in lowskilled IT occupations, and in occupations where economy-wide trends dominate (managers and manufacturing). This mitigates the overall macroeconomic impact to the US economy of such job losses.[21]

Myth #7: American manufacturing jobs are moving to poor nations—especially China.

Fact: Nations are losing manufacturing jobs worldwide—even China.

U.S. manufacturing jobs are down by 2.45 million in the past three years. The zero-sum view of the world imagines that these jobs went somewhere else—specifically that American jobs were exported to a country with lower wages.

However, America is not alone in experiencing declines in manufacturing jobs. U.S. manufacturing employment declined by 11 percent between 1995 and 2002, which is identical to the average world decline according to a study by Alliance Capital Management.[22] Contrary to the myth, China's losses were even sharper: 15 percent of its industrial jobs over the same period.

The real culprits for declining numbers of manufacturing jobs in all countries are increasing productivity, capital investment, and technological innovation. Although manufacturing jobs have

18. Organisation for International Investment, "The Facts About Insourcing," at *www.ofii.org/insourcing* (April 27, 2004).

19. *Ibid*.

20. Jacob F. Kirkegaard, "Outsourcing—Stains on the White Collar?" Institute for International Economics, February 2004, at *www.iie.com/publications/papers/kirkegaard0204.pdf*.

21. *Ibid*.

22. Jon E. Hilsenrath and Rebecca Buckman, "Factory Employment Is Falling World-Wide," *The Wall Street Journal*, October 20, 2003, p. A2.

declined in America over the past decade, U.S. manufacturing output has jumped by 38 percent.[23] Today, the U.S. manufacturing sector produces more than the entire Chinese economy.

Trade should not be blamed for what is really a technological process, especially because America has experienced this job-winnowing productivity trend for decades. Current job losses of 2.45 million in manufacturing are nearly identical to the sharp hit that manufacturing experienced between 1979 and 1982. Employment recovered then, but only when new companies created new jobs in new sectors.

Myth #8: Only greedy corporations benefit from outsourcing.

Fact: *Everyone* benefits from outsourcing.

Critics err seriously in trying to divorce benefits for corporations from benefits accruing to all Americans. Outsourcing is about keeping costs down in response to competition. As costs decline, every consumer benefits. The vast benefits from lower costs are usually overlooked because the benefits are diffused throughout the economy.

In contrast, the much smaller cost of jobs lost to outsourcing is sharply focused. In other words, the relative few who lose their jobs to outsourcing are far more vocal than the millions of consumers who save a few hundred dollars each year due to lower prices for such things as computers, cell phones, and cars.

Early studies found that the gains of trade outweighed losses by 50 to 100 times. More recent studies also take the serious matter of job dislocations into account. A 2003 study by Michael W. Klein, Scott Schuh, and Robert K. Triest includes dislocation costs in its calculations, concluding that the benefits of trade outweigh its costs by 100 percent, or 2 to 1.[24] Overall, free trade saves American consumers billions of dollars.

Myth #9: The government can protect American workers from outsourcing.

The underlying myth is that free trade is not fair trade because fair trade can "protect" American companies and workers.

Fact: Protectionism is isolationism and has a history of failure.

Lawmakers have a longstanding record of pandering to specific interest groups on all issues, but the economic damage can become acute when the issue is trade. Misleading protectionist rhetoric fuels policies that are designed to placate these special interests and should be called what it really is: economic isolationism. One example is the recently imposed—and later rescinded—steel tariffs, which raised steel prices for all U.S. manufactures, hindered competitiveness, destroyed jobs domestically, and violated trade agreements.[25]

A recent flurry of anti-outsourcing proposals in Congress and at least 36 states threatens businesses that engage in free trade and investment.[26] Aside from inviting retaliation, clamping down on the ability of U.S. firms to open subsidiaries abroad will simply erode their competitiveness.

Economic isolationism is not new, and it has been an abject failure whenever adopted. A well-known example is the Smoot–Hawley tariff, enacted by Congress in June 1930 to reduce imports and protect American businesses and jobs.[27] Smoot–Hawley did halve imports between 1929 and 1933, but exports also declined by half over that period.[28] Subsequently, the rate of unemployment grew from 3.2 percent in 1929 to 8.7 percent in 1930 and

23. Federal Reserve, "Industrial Production and Capacity Utilization," Statistical Release G.17, updated December 17, 2002, Table 1 and Table 2, at *www.federalreserve.gov/Releases/g17/table1_2.htm*.

24. Jeff Madrick, "Economic Scene; As Job Exports Rise, Some Economists Rethink the Mathematics of Free Trade," *The New York Times*, March 18, 2004, at *www.nytimes.com/2004/03/18/business/18scene.html*, and Michael W. Klein, Scott Schuh, and Robert K. Triest, *Job Creation, Job Destruction, and International Competition* (Kalamazoo, Mich.: W. E. Upjohn Institute for Employment Research, 2003).

25. Editorial, "Steeling Our Wealth," *The Wall Street Journal*, September 23, 2003, p. A24, and editorial, "Steel Trapped Minds," *The Wall Street Journal*, February 19, 2002, p. A26.

26. Shannon Klinger and M. Lynn Skyes, "A Legal Analysis of State and Federal Outsourcing," National Foundation for American Policy, April 2004, at *www.nfap.net/researchactivities/studies/NFAPStudyExportingLaw_0404.pdf*.

peaked at 24.9 percent in 1933. U.S. efforts to constrict outsourcing can be expected to meet similar barriers among U.S. trade partners, harming Americans and the global economy.

It is not in America's interest to fall victim to hostile trade rhetoric. Bills before Congress and the states that restrict outsourcing are sending exactly the wrong image: a wealthy America that jealously guards against its prosperity and freedom leaking out to the Third World. This hostility only breeds resentment against America and makes efforts to adopt greater economic freedom around the world more difficult.

Myth #10: Unemployment benefits should be extended beyond 26 weeks.

Fact: Jobless benefits are already working.

The median duration of unemployment is 9.5 weeks, which means that the vast majority of workers who can file for jobless benefits are fully covered by the existing unemployment insurance program of 26 weeks. Calls for extensions are inappropriate, given that new weekly jobless claims are down by more than 100,000 in the past year (10 percent below the long-term average) and continuing claims are down by 700,000.

The goal of unemployment insurance is to help Americans make the transition to a new job, and it is working. Extending the standard 26 weeks of coverage to 39 weeks would cost billions of dollars and do little to help the workforce reorient to new sectors.

What Should Be Done

America's workers deserve a more informative, less partisan debate on outsourcing. Outsourcing's negative impact on the economy and American employment has been greatly exaggerated, while its benefits have been almost entirely ignored.

The real problem is not trade, investment, or low wages overseas. The real culprit is not labor-related at all, but the reduced competitiveness of the U.S. business environment. Instead of focusing on the non-issue of outsourcing, Congress and the Administration should cooperate to strengthen the U.S. economy and benefit individual workers and all Americans by:

- Ending lawsuit abuse. Frivolous lawsuits cost the U. S. economy between $180 billion[29] and $233 billion in 2003,[30] which is enough to pay 1.8 million to 2.3 million additional six-figure salaries. According to one study, this is up 13.3 percent over 2002, following a 14.4 percent increase over 2001, and strongly suggests continued double-digit growth unless steps are taken to end frivolous and abusive lawsuits.[31]

  Congress should take steps to reform class-action lawsuits and restrain the growth of medical malpractice lawsuits. Since one-third of the increase in tort costs is driven by increasingly broad asbes-

27. The justification for Smoot–Hawley is laid out in the 1928 Republican Party Platform: "[W]e realize that there are certain industries which cannot now successfully compete with foreign producers because of lower foreign wages and a lower cost of living abroad, and we pledge the next Republican Congress to an examination and where necessary a revision of these schedules to the end that American labor in the industries may again command the home market, may maintain its standard of living, and may count upon steady employment in its accustomed field." "Republican Platform [of 1928]" in Arthur M. Schlesinger, Jr., Fred L. Israel, and William P. Hansen, eds., *History of American Presidential Elections, 1789–1968*, Vol. 3 (New York: Chelsea House, 1971), from Anthony O'Brien, "Smoot–Hawley Tariff," *EH.Net Encyclopedia*, ed. Robert Whaples, August 15, 2001, at *www.eh.net/encyclopedia/contents/obrien.hawley-smoot.tariff.php*.
28. "U 1-14 Value of Exports and Imports: 1790 to 1957," data series, in U.S. Bureau of the Census, *Historical Statistics of the United States: Colonial Times to 1957*, p. 537, and Federal Reserve Bank of Minneapolis, "Consumer Price Index 1913—," at *minneapolisfed.org/Research/data/us/calc/hist1913.cfm* (April 28, 2004).
29. Council of Economic Advisers, "Who Pays for Tort Liability Claims? An Economic Analysis of the U.S. Tort Liability System," April 2002, at *www.whitehouse.gov/cea/tortliabilitysystem_apr02.pdf*.
30. Tillinghast–Towers Perrin, "U.S. Tort Costs: 2003 Update: Trends and Findings on the Cost of the U.S. Tort System," February 2003, at *www.towersperrin.com/tillinghast/publications/reports/2003_Tort_Costs_Update/Tort_Costs_Trends_2003_Update.pdf* (May 5, 2004).
31. *Ibid*.

tos awards, lawmakers should limit damages for non-sick claimants. Businesses pay these costs in three ways beyond payment of tort claims: through increasing product and general liability insurance, higher employee health-care benefits due to medical liability costs, and legal fees. The burden these costs impose on the economy is more than two times greater than the burden on some major U.S. trading partners (e.g., Japan and Canada), putting American businesses at a competitive disadvantage.[32]

- **Eliminating overly burdensome regulations.** Regulatory compliance costs the U.S. economy nearly $850 billion a year,[33] approaching the amount Americans pay in federal income tax. While some regulation is necessary—such as rules to protect against fraud—much is unneeded and overly burdensome. As the Council of Economic Advisers has observed:

  > [T]he absence of competition, enforceable property rights, or an ability to form mutually advantageous contracts can result in inefficiency and lower living standards. In some cases government intervention in a market, for example through regulation, can create gains for society by remedying any shortcomings in the market's operation. Poorly designed or unnecessary regulations, however, can actually create new problems or make society worse off by damaging parts of the market that do work.[34]

  Congress should strengthen the review process for all proposed regulations, with stricter guidelines for conducting and evaluating cost-benefit analyses and greater resources for reviewers to critically examine the effects of proposed regulations. Policymakers should target regulatory reforms in areas ranging from burdensome telecommunications rules that slow progress toward next-generation Internet technologies, to unnecessarily costly environmental regulations that make economic growth difficult, to outdated workplace regulations that discourage job creation.[35]

- **Simplifying and flattening the tax code.** America's tax code is overly complex and incredibly inefficient. Special tax breaks to politically connected businesses, groups, and voting blocs have resulted in a bewilderingly complex mess that forces corporations and individuals to spend at least $194 billion each year to comply with the ever-changing tax code.[36] Adopting a simpler and flatter tax code would eliminate the need for this waste of time and money, free billions of dollars for more efficient uses, and remove incentives against saving that leave many workers with little cushion during hard times.[37]

  Moreover, eliminating counterproductive tax policies that undermine U.S. business competitiveness, such as America's policy of worldwide taxation and reducing the U.S. corporate tax rate (the second highest in the industrialized world), would greatly benefit American businesses, and hence American jobs.[38] President

32. Jeremy A. Leonard, "How Structural Costs Imposed on U.S. Manufacturers Harm Workers and Threaten Competitiveness," Manufacturers Alliance/MAPI, p. 16. Data available for only five of nine key U.S. trading partners: Canada, Japan, Germany, the United Kingdom, and France. The U.S. tort burden of 2 percent of GDP is more than double all but Germany, whose burden is 1.3 percent of GDP.
33. W. Mark Crain and Thomas D. Hopkins, *The Impact of Regulatory Costs on Small Firms*, a report for the Office of Advocacy, U.S. Small Business Administration, RFP No. SBAHQ–00–R–0027, at *www.sba.gov/advo/research/rs207tot.pdf* (May 5, 2004).
34. *Economic Report of the President*, February 2004, p. 149.
35. For a more detailed discussion, see "Regulation," in *Issues 04: The Candidate's Briefing Room* (Washington, D.C.: The Heritage Foundation, 2004), at *www.heritage.org/research/features/issues2004/regulation.cfm*.
36. Scott Moody, "The Cost of Tax Compliance," Tax Foundation, February 2002, at *www.taxfoundation.org/compliance2002.html*.
37. For a more detailed discussion, see Daniel J. Mitchell, Ph.D., "How Taxes Reduce Savings," Heritage Foundation *Backgrounder* No. 1309, July 22, 1999, at *www.heritage.org/Research/Taxes/BG1309.cfm*.

Bush's tax cuts move the tax code in the right direction and should be made permanent, but substantial gains remain unrealized.[39]

- **Ensuring affordable and reliable energy supplies.** While consumers readily complain about increases at the gas pump and in their utility bills, the high costs of energy also hurt America's employers. Manufacturers alone consume 30 percent of electricity and 40 percent of natural gas.[40] Thus, national energy policies directly affect the cost of American goods and the ability of companies to create jobs.

  Congress should remove mandates that force the utility industry to use power from renewable producers (e.g., wind) and instead allow the market to equate real demand and supply and find the right role for the renewable energy industries. Likewise, policymakers should reform the current command-and-control regulatory scheme of the Clean Air Act and replace it with a market-based approach that sets standards and allows the electric industry the flexibility to meet those standards in the most efficient and cost-effective manner possible while simultaneously enhancing the nation's air quality.

  Congress should also address the needs of the electricity grid by eliminating restrictive regulations that discourage investment—such as the Public Utilities Holding Company Act—and utilize innovative transmission pricing incentives. Finally, Congress should increase domestic supplies of energy by opening up access to reserves that are currently off limits or restricted.

Conclusion

Outsourcing is not a credible threat to the U.S. economy, and objective research is quickly debunking its many underlying myths. At worst, outsourcing is a politically charged trigger word that has the potential to advance seriously flawed economic policy. For example, if state governments begin to bar contracts with firms that subcontract any work overseas, they will hamstring the competitiveness of U.S. firms.

Policymakers cannot stop the process of outsourcing any more than they can stop gravity, but they can scare off profitable U.S. companies. Businesses survive on slim profit margins, and threatening competitiveness will be felt immediately where it hurts the most—in U.S. jobs and salaries.

American companies lead the world in developing sophisticated global supply chains in close coordination with worldwide trading partners. Any disruption to the efficiency of that supply-chain network will have a negative ripple effect. By criticizing and regulating multinational companies that trade, invest, outsource, and insource, Congress is paving the way to major disruptions in efficiency that will lead simultaneously to both inflationary and recessionary pressures.

Instead, policymakers should address the underlying reasons that would induce a company from any country to site a business on foreign soil instead of in the U.S. In a global economy with global competition, the cost environment of taxes and regulation looms larger than ever. Although America has the world's most productive and skilled workforce, its relatively high tax rates, tax complexity, burdensome regulations, and frivolous lawsuits discourage job creation.

The question is not the outsourcing of jobs, but the forcing out of jobs through inept policy. Congress and states would be wise to continue America's tradition of free and open markets.

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38. Daniel J. Mitchell, Ph.D., "Making American Companies More Competitive," Heritage Foundation *Backgrounder* No. 1691, September 25, 2003, at *www.heritage.org/Research/Taxes/BG1691.cfm*.

39. For a more detailed discussion, see "Taxes," in *Issues 04*.

40. U.S. Department of Commerce, *Manufacturing in America: A Comprehensive Strategy to Address the Challenges to U.S. Manufacturers*, January 2004, p. 66.