

Major Themes in Economics

Volume 8

Article 4

Spring 2006

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Recommended Citation

VanderWeerd, Gwynn (2006) "Analyzing the Debate over Offshore Outsourcing in the Service Industry: Is there a Reason for Concern?," *Major Themes in Economics*, 8, 11-25.

Available at: <https://scholarworks.uni.edu/mtie/vol8/iss1/4>

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Analyzing the Debate over Offshore Outsourcing in the Service Industry: Is there a Reason for Concern?

Gwyn VanderWeerd

ABSTRACT. The United States has experienced an increase in the offshore outsourcing (offshoring) of jobs in the service industry. Although offshoring is common in the manufacturing industry, it only recently began in the service industry. The recent increase in the service industry has occurred because of new technology and the ability to access information from anywhere. Those who oppose offshoring believe it takes away American jobs, lowers wages, causes a decline in America's standard of living, and any benefits from offshoring are unevenly distributed. Statistics on unemployment rates, mass layoffs, the trade deficit, GDP, and wage rates are analyzed to show that overall, offshoring in the service industry has not negatively affected the United States. Currently, offshore outsourcing in the service industry has a net benefit to society and there is no reason for concern.

I. Introduction

The United States has experienced its slowest rate of new job growth in decades. In Iowa, 45,000 jobs were lost between 2000 and 2003. All states have not experienced job losses, but the disappearing jobs have many people concerned. Many blame the increase in offshore outsourcing. Some estimate that 3.3 million jobs will be lost to outsourcing in the next decade.

Offshore outsourcing has received a lot of attention and is often debated. In the last three presidential campaigns, offshore outsourcing was a topic for debate. More specifically, in the last presidential campaign in 2004, the focus was on the offshore outsourcing of white-collar jobs in the service industry. Greg Mankiw, chairman of the White House Council of Economic Advisors, brought more attention to the debate when he made the comment that offshore outsourcing white-collar jobs was inevitable and that it is "just a new way of doing international trade" [as quoted in Farnsworth, 2004, 2]. Many believed that Mankiw said the government was okay with Americans losing their jobs. His comment sparked much political debate about offshore outsourcing and what the next president would do to prevent high-skilled jobs from leaving the United States.

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Jobs in the service industry used to be thought safe, but that is no longer true. With the introduction of new technology and the ability to access information all over the world, companies now have the opportunity to outsource these jobs to other countries. Offshore outsourcing has occurred in the manufacturing industries for several decades, but it affected only low-skilled jobs, or blue-collar workers. People did not complain about this outsourcing because they saw the benefits of this type of trade in the form of lower prices for the goods they purchased. Those in the service sector were strong supporters of open trade because they benefited from the cheap goods [Rajan and Wei, 2004, 1]. People fear that the latest trend of outsourcing service jobs to other countries will take high-paying jobs away from American workers. People are concerned about unemployment rates increasing and wage rates declining.

Many articles have been written on the topic of offshore outsourcing, and everyone seems to have an opinion about offshore outsourcing in the service industry. Many people request that the government increase trade restrictions while others seek more open markets and free trade among countries. The purpose of this paper is to analyze both sides of the argument about service offshore outsourcing, examine statistics, and determine if there really is a need for concern about negative effects from outsourcing. The conclusion is that offshore outsourcing in the service industry provides a net benefit to society and at present there is no reason for concern.

II. Background

A. DEFINING OFFSHORE OUTSOURCING

Outsourcing refers to a company obtaining inputs or services from a firm outside the company [Amiti and Wei, 2005a, 313]. This type of outsourcing has occurred for many years between companies in the United States and occurs when a business has another business perform some task for it (e.g., accounting practices, legal practices, manufacturing a specific part) because the other business can do it for a lower cost. The other business has the comparative advantage in that task; therefore, outsourcing benefits both sides.

Offshore outsourcing (also commonly called offshoring or international outsourcing) refers to a company obtaining inputs or

services from a firm in a foreign country [Amiti and Wei, 2005a, 313]. The object of offshore outsourcing is the same as that of outsourcing, but the former involves the transfer of goods or services between countries. The concept of comparative advantage still applies. Businesses have discovered that they can hire workers in other countries for a lower wage rate, which lowers their cost of production.

B. JOBS THAT ARE AT RISK

Jobs that are more likely to be outsourced have some common characteristics, according to Garner's report from the Federal Reserve Bank of Kansas City [2004, 16-18]. Service jobs that are labor-intensive are more likely to be outsourced, especially if labor is a high percentage of the total production costs. Firms will see a larger decrease in production costs when they move these jobs to a country where labor costs are very low. An example of a common labor-intensive job internationally outsourced in the service industry is telemarketing, or call centers. Capital-intensive jobs often stay in the United States.

Information-based jobs are also likely candidates for offshore outsourcing, according to Garner. Jobs that have a significant amount of information available to workers are outsourced because the information can now be accessed anywhere in the world. The internet and improved communication channels have allowed for easy accessibility of information. Common service jobs that are information-based are accounting, customer service, and billing.

Jobs that have a strict set of rules or instructions are also at risk for outsourcing. Companies are able to outsource this type of job because workers can follow specific instructions and do not need constant input or feedback from managers. No judgment decisions exist in these jobs. Offshore outsourcing is common with customer service jobs where workers follow a specific script, according to the customers' needs.

A final characteristic, according to Garner, is a high degree of transparency in the information transferred. An example of a company with a high degree of transparency in information is a credit card company. Credit information is easily accessible, so credit card companies can outsource their credit checks to wherever the cost of labor is lowest. In jobs where information is scarce, face-to-face contact is required. These jobs are more difficult to outsource.

C. RECENT TRENDS

The increase in offshore outsourcing in the service industry is a new trend. Prior to the past decade, it was uncommon for developing countries like China or India to export high-valued, or high-skilled, services [Trefler, 2005, 4]. Researchers have given several reasons for the recent increase in offshoring. These reasons include: innovative technology and new openness to trade [Trefler, 2005, 17]; improvements in telecommunications, globalization of finances, and reduction of entry costs worldwide [Jones, Kierzkowski, and Lurong, 2004, 306]; declining tariffs and transportation costs [Miller, 2001, 270]; lower production costs in foreign countries, technology changes, and deregulation [Garner, 2005, 12-15]; and technological innovation, fewer barriers to trade, cost savings that occur, and a larger pool of skilled English-speaking people in other countries [Kirkegaard, 2004, 23]. Locating workers in different time zones allows 24-hour service, which is another benefit from international outsourcing [Farnsworth, 2004, 1]. Companies have found that they now have access to cheap and well-trained labor forces in other countries [Rajan and Wei, 2004, 1].

Previously, people in the service industry thought their jobs were safe because of the necessity of dealing with customers face-to-face [Schroeder and Aeppel, 2003, para. 4]. With the introduction of the internet, face-to-face contact is not always required. Workers in these jobs can access the necessary information through the internet or advanced communication networks. The internet makes transferring data easier and more cost effective [Farnsworth, 2004, 1]. Some examples of service jobs currently outsourced include call centers, computer software development, design engineers, skilled machinists, and research and development.

Most people believe offshore outsourcing will continue to increase [Ameti and Wei, 2005b; Garner, 2004, 6]. As long as workers in other countries are willing and able to work for lower pay than workers in the home country, firms will examine offshore outsourcing as an option to decrease costs of production and increase their competitiveness globally [Siems and Ratner, 2003, para. 2]. As long as a comparative advantage exists, firms will offshore production. Some predict that 340,000 American jobs will be offshored per year between 2010 and 2015 [Garner, 2004, 10]. 3.4 million jobs are predicted to be offshored by 2015 [Ogloblin, 2004, 6].

Many believe that service offshore outsourcing has received so much attention lately because the United States has seen its weakest job growth in recent decades [Little, 2004, 2]. The American economy faced a recession in the early 2000s but is slowly making a turnaround. Some say that if the job market were not so bad no one would complain about the increase in outsourcing. Others say outsourcing is the reason for the bad job market. This debate leads to the controversy over the issue of offshore outsourcing in the service industry.

III. The Controversy

Many people see offshore outsourcing as dangerous to the American economy and have expressed concern over the number of high-paying jobs that are filled by non-American workers in other countries. Other people see this type of outsourcing as a form of trade and believe that trade generally benefits society. Implementing any restrictions harms the economy. Both sides have valid points but approach the topic from different viewpoints.

A. OPPOSITION TO OFFSHORE OUTSOURCING

One of the many concerns about offshore outsourcing is the loss of American jobs. Some fear that if jobs continue to be transferred to foreign countries there will not be any jobs left at home. In the 1990s, the fear was about jobs going to Mexico. Now the fear is about jobs going to China and India [Rajan and Wei, 2004, 1]. Jobs lost to outsourcing are likely to be permanent [Garner, 2004, 20]. People are worried about the unemployment rate and believe that the rate is rising because of the increase in offshore outsourcing. A poll taken in July 2004 found that 72 percent of respondents believed that offshore outsourcing was a bad trend because the offshoring took jobs away from American workers [Program on International Policy Attitudes]. Another poll taken in January 2004 found that 63 percent believed more jobs are lost from imports than any other reason while only 8 percent said more jobs are gained from exports [Program on International Policy Attitudes].

Lower wages is another concern people have about offshore outsourcing. People feel they now have to compete with workers in other countries who are willing to work for lower wages than Americans. American workers believe they will have to settle for lower wages or risk

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losing their jobs to foreign workers. Some believe being forced to accept lower wages is unfair to American workers because the cost of living is much higher in the United States compared to developing countries. Americans feel they cannot afford a cut in their wages.

Another concern about offshore outsourcing comes from the distributional effects of trade [Poole, 2004, 2]. Many Americans believe free trade primarily benefits the businesses doing the offshoring and the wealthy. In a poll taken in January 2004, 51 percent of respondents believed international trade had a positive effect on businesses, while 45 percent believed it had a negative effect on workers [Program on International Policy Attitudes]. In another poll taken in July 2004, 59 percent believed international trade was good for American businesses and 64 percent said international trade was bad for the job security of American workers. 'The rich get richer' is a common belief, and many domestic consumers feel they are not seeing the benefits of service outsourcing reflected in the prices they pay.

A final concern is a declining standard of living. This issue is connected to the concern about lower wages. If American workers have to accept lower wages in order to keep their jobs, their standard of living is going to fall. They are no longer going to be able to afford the consumption they had at the higher wage. To avoid financial troubles, people will have to cut their consumption, therefore lowering their standard of living.

B. SUPPORT FOR OFFSHORE OUTSOURCING

The basic claim in support of offshore outsourcing is that it is a form of free trade. The arguments that support free trade also support international outsourcing; outsourcing lowers costs and encourages competitiveness [Rajan and Wei, 2004, 1]. This argument often comes from economists who approach the topic by looking at the long term effects, whereas non-economists look at the short term effects. Economists acknowledge that some jobs are lost with outsourcing, but many people forget the number of jobs created during this same time period. Job losses are painful, but they are a necessary part of innovation and increasing productivity [Lindsey, 2004, 1].

Another reason given in support of offshore outsourcing is its positive effect on productivity. If a business can relocate the inefficient processes of its production to a firm who can produce those same processes at a

lower cost, the business can then focus on its more efficient processes. If businesses are allowed to focus on what they do best, the productivity of their workers increases significantly. Amiti and Wei [2005b, 18] found that service offshore outsourcing has a positive effect on productivity in the United States. Their research concluded that outsourcing accounted for 11 percent of the productivity growth between 1992 and 2000. With an increase in productivity, firms are able to produce more products or services at a lower cost, which increase their profits.

A final reason people support offshore outsourcing is that they believe the economy as a whole benefits. Garner [2004, 22] believes outsourcing has helped to drive down costs of high-tech goods and sped up the adoption of new technologies. A McKinsey study found that two thirds of the economic benefit from offshoring spills back into the United States' economy [Schroedder and Aepel, 2003, para. 6]. The economic benefit is seen in lower prices of goods and services, expanding markets for American goods, and increasing profits for American firms. Outsourcing helps raise the standard of living through lower costs of goods and also higher profits for firms. As firms realize higher profits, they are likely to expand their investments in American plants and equipment and increase dividend payments [Garner, 2004, 21]. Firms will be more efficient and increase their competitiveness. Firms can expand production in other areas, and new jobs will likely be created.

IV. Looking at the Statistics

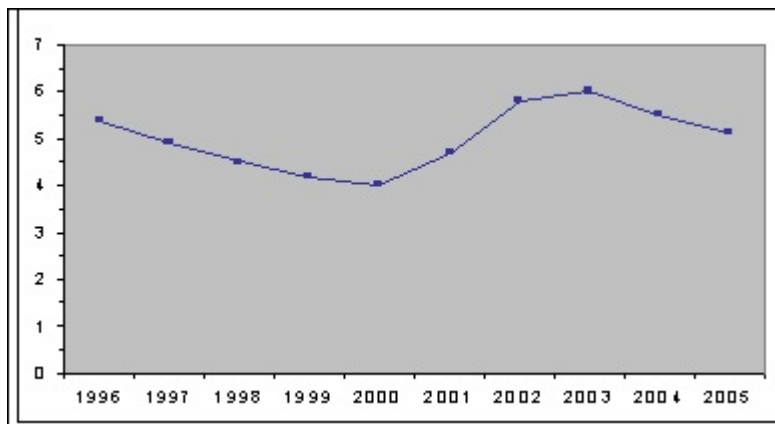
Four main statistics need to be considered to determine if people's concerns about the effects of offshore outsourcing are legitimate. The five statistics include unemployment rates, mass layoffs statistics, the trade deficit, GDP, and wage rates.

A. UNEMPLOYMENT RATES

The unemployment rate is one of the biggest concerns. But looking at past trends, the unemployment rate has not changed drastically. The rate has stayed constant at around 5 percent (see Table 1). Rajan and Wei [2004, 2] found that the number of jobs lost to outsourcing is offset by the number of jobs created with insourcing. New positions are constantly created as old ones are eliminated by outsourcing [Lindsey, 2004, 1]. Studies have shown that the net change in job gains and losses is actually

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positive, with total employment increasing [Lindsey, 2004, 3; Poule, 2004, 4; Kirkegaard, 2004, 29].



Source: U.S. Department of Labor, Bureau of Labor Statistics, www.bls.gov

Figure 1: Unemployment Rate by Year

The unemployment rates in each industry within the service industry also need to be considered. Some industries are more affected by offshoring than others. When looking at unemployment rates by industry, one will see that they also are relatively constant (see Table 2). Amiti and Wei [2005b, 19] found that a small negative effect, less than one percentage point, existed in industries that outsource, but this effect disappears when looking at all industries. Any negative effects in one industry are offset by job creation in other industries.

Table 1—Unemployment Rate by Industry and Year

Industry	2000	2001	2002	2003	2004	2005	2006 (Jan. only)
Information	3.2	4.9	6.9	6.8	5.7	5.0	3.3
Financial Activities	2.4	2.9	3.5	3.5	3.6	2.9	2.4
Professional and Business Svcs	4.8	6.1	7.9	8.2	6.8	6.2	6.5
Education and Health Services	2.5	2.8	3.4	3.6	3.4	3.4	3.2
Leisure and Hospitality	6.6	7.5	8.4	8.7	8.3	7.8	8.1
Other Services	3.9	4.0	5.1	5.7	5.3	4.8	4.9

Source: U.S. Department of Labor, Bureau of Labor Statistics, www.bls.gov

Almost all industries saw an increase in the unemployment rates in the early 2000s, but have seen their rates stabilize over the past two years. This change in rates is not primarily due to offshore outsourcing, but due to the recession faced by the economy during this period. The economy faced hard times from the burst of the stock market bubble, terrorist attacks, and various accounting scandals in several large corporations. The rise in unemployment, therefore, came from the unstable economic conditions rather than the increase in offshore outsourcing. Ogloblin [2004, 18] concluded that the higher unemployment in 2004 compared to 2000 was not related to offshore outsourcing, but due to the struggling economy. No significant impact on overall unemployment exists.

B. MASS LAYOFFS

Another important statistic to help analyze the impact of offshore outsourcing is mass layoffs. The Bureau of Labor Statistics gathers data in a program called the Mass Layoff Statistics Program. The Mass Layoff Statistics Program records significant layoffs of 50 or more workers lasting 31 days or more. Employers are asked to indicate the number of workers laid off and the reason for the layoff. When comparing the number of mass layoffs because of overseas relocation (or offshore outsourcing) to the total number of mass layoffs, one will see that overseas relocation accounts for a small percentage of the total mass layoffs. This number is usually less than one percent (see Table 3). The number of mass layoffs did increase by close to 600,000 workers between 2000 and 2001, but the increase in mass layoffs due to overseas relocation was only 6,000 workers in that same time period. The struggling economy, not offshore outsourcing, can be blamed for the large increase in mass layoffs during that time period.

The Mass Layoff Statistics Program does have some drawbacks that need to be acknowledged. The data gathered through this program only look at firms employing 50 or more workers, so any layoffs that occur in firms with less than 50 workers are not included. Also, employers are asked to self-identify the reason the layoff occurred, and with the unfavorable attention that offshore outsourcing has received in recent years, many employers may be inclined to refuse to report the reason or not answer truthfully [Kirkegaard, 2004, 28]. These problems would not

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affect the data significantly, though, because the number of workers laid off would still be relatively small.

Table 2—Extended Mass Layoffs Resulting in Separations

Year	Mass Layoffs due to Overseas relocation	Total Mass Layoffs	Percent of Total Mass Layoffs due to overseas relocation
1996	4,326	1,184,355	0.365
1997	10,439	1,146,115	0.910
1998	8,797	1,227,573	0.717
1999	5,683	1,149,267	0.494
2000	9,054	1,170,427	0.774
2001	15,693	1,751,368	0.896
2002	17,075	1,546,976	1.104
2003	13,205	1,503,277	0.878

Source: U.S. Department of Labor, Bureau of Labor Statistics, www.bls.gov

C. TRADE DEFICIT

Some people are concerned that the American economy will suffer if it increases its imports in the service industry. People are anxious about the trade deficit increasing. What most people do not realize is that rich, industrialized countries are the ones doing the most insourcing, not outsourcing, in the service industry [Amiti and Wei, 2005a, 327]. Most developed countries run surpluses in the service industry because other countries are outsourcing to them. The United States exports more services than it imports [Little, 2004, 6]. In 2003, the United States ran a surplus of close to \$60 billion in services alone [Garner, 2004, 6]. The United States and the United Kingdom have the two largest surpluses in service trade [Ameti and Wei, 2005a, 338]. So, while the United States may have a trade deficit overall, the deficit is not caused by outsourcing in the service industry. Rather, the large amount of insourcing in the service industry has helped lower the trade deficit (see Table 3).

Table 3—U.S. International Trade in Goods and Services
(in millions of dollars)

Year	Balance			Exports			Imports		
	Total	Goods	Servs.	Total	Goods	Services	Total	Goods	Servs.
1995	-96,384	-174,170	77,786	794,387	575,204	219,183	890,771	749,374	141,397
1996	-104,065	-191,000	86,935	851,602	612,113	239,489	955,667	803,113	152,554
1997	-108,310	-198,104	89,794	934,637	678,366	256,271	1,042,947	876,470	166,477
1998	-165,009	-246,687	81,678	933,495	670,416	263,079	1,098,504	917,103	181,401
1999	-263,394	-346,015	82,621	966,443	683,965	282,478	1,229,837	1,029,980	199,857
2000	-378,272	-452,414	74,142	1,071,484	771,994	299,490	1,449,756	1,224,408	225,348
2001	-362,729	-427,188	64,459	1,007,138	718,712	288,426	1,369,867	1,145,900	223,967
2002	-421,180	-482,297	61,117	977,276	682,422	294,854	1,398,457	1,164,720	233,737
2003	-494,814	-547,296	52,482	1,022,567	713,421	309,146	1,517,381	1,260,717	256,664
2004	-617,583	-665,390	47,807	1,151,448	807,536	343,912	1,769,031	1,472,926	296,105
2005	-725,759	-782,101	56,342	1,271,102	892,512	378,590	1,996,862	1,674,614	322,248

Source: U.S. Census Bureau, Foreign Trade Statistics, www.census.gov

D. GROSS DOMESTIC PRODUCT (GDP)

Looking at service imports as a percentage of GDP also gives a reason not to be concerned about offshore outsourcing. In 2003, computing and business service imports accounted for only 0.4 percent of total GDP [Amiti and Wei, 2005a, 312]. Little [2004, 6] found that imports of business and professional services were only 0.7 percent of total GDP in 2005. The lack of systematic statistics for service offshoring sparks a concern [Amiti and Wei, 2005b, 4; Kirkegaard, 2004, 23-25]. The reported percentage of total GDP may be distorted as a result of estimating service offshoring. The numbers mentioned previously are only estimates. But, even if the percentages obtained were doubled, the percentages would still be a small fraction of total GDP.

Since data are not currently collected to measure the dollar amount of services outsourced to other countries, this number can be estimated as a small part of service imports. Calculating service imports as a percentage of GDP indicates that this percentage has averaged around two percent in the past decade (see Table 4). This percentage implies that imports of services have a small effect on total GDP. Since outsourcing of services is only a small part of service imports, outsourcing of services is an even smaller percentage of total GDP. Looking at that table also shows that the amount of service imports has increased in the past decade, but GDP has also increased at the same time. Service imports as a percent

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of GDP is still only 2.6 percent in 2005.

Table 4—U. S. Gross Domestic Product (in billions of dollars)

Year	Service Imports	Total Gross Domestic Product	Service Imports as a Percent of GDP
1995	146.1	7,397.7	1.975
1996	157.4	7,816.9	2.014
1997	171.5	8,304.3	2.065
1998	186.9	8,747.0	2.137
1999	206.3	9,268.4	2.226
2000	232.3	9,817.0	2.366
2001	231.9	10,128.0	2.290
2002	241.0	10,469.6	2.302
2003	262.6	10,971.2	2.394
2004	301.9	11,734.3	2.573
2005	327.3	12,485.7	2.621

Source: U.S. Department of Commerce, Bureau of Economic Analysis, www.bea.gov

E. WAGE RATE

Declining wage rates is a concern for many people. Some people believe that if someone loses her job to offshoring, the job she finds to replace her old job will offer a lower wage. No statistic is currently collected to see if this is true or not. Another way to examine this issue is to look at the average hourly earnings in the service industry to see if the average wage rate is falling because of the increase in offshoring (see Graph 2). The graph shows that the wages of service workers was increasing from 1996 until 2003. Only in the past couple of years has the wage rate fell, by \$0.20. The decline is small and may not be primarily due to offshoring, but to the struggling economy. Wage rates for the specific industries within the service industry had similar graphs.

The wage rate in the service industry needs to be watched in the next five years to see if it continues to fall or if the rate rises as the economy turns around. The main reason to watch the wage rate in this industry is because of what occurred in the goods-producing industry. The wage rate in this industry declined rapidly during the 1980s and early 1990s. It was during this period that offshoring was on the rise in such industries.

People may have a legitimate reason to be concerned over falling wages if the wage rate in the service industry continues to decline even as the economy takes off. Currently though, the decrease is small and there is no reason to be concerned about a falling wage rate.



Source: U.S. Department of Labor, Bureau of Labor Statistics, www.bls.gov

Figure 2. Service-Providing Industry
Average Hourly Earnings (in 1982 Dollars)

V. Conclusion

A large majority of Americans are concerned about the increase in service offshore outsourcing in recent years, mainly because of a fear of losing their jobs, lower wage rates, or lower living standards. Many believe that only the businesses involved benefit from offshoring. Other people support the increase in offshore outsourcing and believe offshoring is beneficial to society. They find that international outsourcing is a form of trade, and trade allows firms to specialize. Specialization leads to increases in productivity, which lead to improvements in the overall economy. Firms realize higher profits and consumers see lower prices.

A look at the statistics supports the second argument. No overall negative effects were found on the unemployment rate. The increasing mass layoffs were not due to the increasing offshore outsourcing, but to the lagging economy. Service offshore outsourcing is not increasing the trade deficit directly, and the United States actually runs a trade surplus

in the service industry. Service imports as a percentage of total GDP is around two percent, a relatively small share of GDP. Finally, the wage rate in the service industry has been increasing for most of the past decade and has only declined slightly in the past two years. Offshore outsourcing has been shown to produce an overall net benefit to society.

One must be careful when talking about this topic because benefits for offshore outsourcing are for the public as a whole. Those who have lost their jobs overseas probably have trouble seeing the net benefit, and they have good reason to be concerned about outsourcing. One must be aware of the overall effect and realize that offshore outsourcing has not hurt the economy, but many good things have occurred because of offshoring. The media enjoys focusing on the bad and talking about how many jobs are lost and forgets to ask how many jobs are created. The economy has suffered in recent years, so the ability to distinguish between the effects of a recession and the effects of a rising trend in offshoring is important.

Future research needs to continue examining and tracking the service offshore outsourcing trend. Research has only begun to be published in this area due to its relative newness [Amiti and Wei, 2005a, 315; Ogloblin, 2004, 6]. Finding a more accurate and consistent way to measure the offshore outsourcing occurring is also needed. Problems currently exist in the way service offshore outsourcing data are collected and in the determination of how many jobs are relocated overseas, possibly understating the total effect of outsourcing. Finally, as the economy is lifted out of the recession, researchers need to examine how this affects the level of offshore outsourcing and also the general public's feelings toward offshore outsourcing.

Service offshore outsourcing is an important topic that affects everyone. Having concern about how outsourcing affects the American economy is necessary, but one must be open to hearing both sides of the issue. As Alan Reynolds from the Cato Institute said, "People focus on the bust and forget the boom" [2004, para. 8]. People often cannot see past the bad (American jobs leaving the country), or see the good (new jobs created from outsourcing). One must be careful before taking a side and examine each side's arguments. With the topic of service offshore outsourcing, one side clearly stands above the other. Service offshore outsourcing is beneficial to the overall economy and any restrictions implemented would be harmful. Currently, there is no need for concern over the increasing offshore outsourcing in the service industry.

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