

The Utility of Offshoring: A Rawlsian Critique

By: Julian Friedland
FRIEDLANDJ@GMAIL.COM

Abstract

Most prominent arguments favoring the widespread discretionary business practice of sending jobs overseas, known as 'offshoring,' attempt to justify the trend by appeal to utilitarian principles. It is argued that when business can be performed more cost-effectively offshore, doing so tends, over the long-term, to achieve the greatest good for the greatest number. This claim is supported by evidence that exporting jobs actively promotes economic development overseas while simultaneously increasing the revenue of the exporting country. After showing that offshoring might indeed be justified on utilitarian grounds, I argue that according to Rawlsian social-contract theory, the practice is nevertheless irrational and unjust. For it unfairly expects the people of a given society to accept job-gain benefits to peoples of other societies as outweighing job-loss hardships it imposes on itself. Finally, I conclude that contrary to socialism, which relies much more on government control, capitalism constitutes a particularly strong moral obligation on corporations themselves to refrain from offshoring.

Those most in favor of offshoring tend to argue that the practice is economically advantageous to everyone over the long-term. Thomas Friedman argues that this insight should compel every nation to adopt a set of policies promoting international trade by freeing up the private sector and removing restrictions to foreign investment. On this view, the long-term economic returns of free trade demand that governments reduce their regulatory control over their respective economies, thus mutually consenting to do what he calls a 'Golden Straitjacket.'¹ While Friedman supports this free market solution in which, as he puts it, 'no one is in charge,'² the utilitarian ethicist Peter Singer advocates a more democratic solution requiring the expansion of global governmental regulatory bodies necessary to ensure the equal consideration of interests.³ Implicit in both of these positions is the normative assumption that no government should prioritize its own citizens' interests in job security over those of the citizens of any other nation. To accept this turns out, on their view, to create the policies that best satisfy the interests of all, thereby achieving the greatest good for the greatest number.

Rawls however provides good reason to consider such an attitude irrational and unjust. Although to my knowledge he never addresses offshoring specifically, it seems a paradigmatic example of why he condemns utilitarianism in general for risking marginalizing the interests of the least advantaged members of society in favor of the best total balance of pleasure over pain.⁴ For in Rawlsian terms, offshoring conducted merely as a discretionary practice unnecessary to sustain commercial success, excessively increases the expectations of some, namely the stockholders, at the expense of stakeholders facing the prospect of job loss.⁵ Furthermore, with respect to the added benefits offshoring offers job-seekers abroad, Rawls unambiguously states in *The Law of Peoples* that no people is prepared to count the benefits for another people as outweighing the hardships imposed on itself.⁶

In what follows, I first attempt to show that discretionary offshoring may indeed be justified on utilitarian grounds.

I then argue on Rawlsian grounds that the practice is nevertheless unjust. Finally I conclude, somewhat ironically, that contrary to socialism, which relies much more on government control, capitalism constitutes a social contract that places a particularly strong moral obligation on corporations themselves to refrain from offshoring.

The Goal of Greatest Global Growth

Proponents of offshoring tend to defend it on the grounds that it is the surest and fastest way to increase the GDP (Global Domestic Product) of every nation worldwide. In other words, it maximizes global average and median GDP. It is therefore generally said to be a 'win-win game.'⁷ Such assessments of course overlook the possibility of facilitating human rights and environmental abuses as a result of outsourcing to on-site facilities in lesser-developed countries with little or no regulatory oversight. Furthermore, in the absence of social safety nets for stabilizing the boom and bust patterns of the free market, offshoring might come at too great a human cost. But such situational contingencies notwithstanding, if offshoring can generally be shown to maximize global economic value, it can be justified on purely economic utilitarian grounds. For although offshoring obviously creates immediate job-winners at the expense of immediate job-losers, so long as it tends to increase global average and median economic value over the long term, it continually stimulates job growth. And since, according to utilitarianism, everyone's interests should be taken into consideration equally, being American grants no greater moral claim to gainful employment than does being Indian, Malaysian, Chinese, Vietnamese, Cambodian, or Bengali. For as Singer famously puts it:

*It makes no moral difference whether the person I help is a neighbor's child ten yards from me or a Bengali whose name I shall never know, ten thousand miles away.*⁸

So if I were to decide for example, as upper level manager of my local community hospital, to fire my neighbor, a father

and radiologist whose job can now be outsourced electronically to India⁹, it would seem there is no moral difference between doing so at his expense and not doing so at the expense of an unemployed Indian radiologist whose name I may never know, ten thousand miles away. And since offshoring the job costs a lot less than keeping it local, as a utilitarian I may very well see the ends as justifying the means, especially if it can be shown that by extension, doing so also increases the value of both the U.S. and Indian economies, thereby creating more jobs at home and abroad.

At this point, let us turn to specific data on how offshoring has affected economic growth and job creation internationally over the last few years. The McKinsey Global Institute, research arm of McKinsey & Co. Management Consulting, recently published a revealing analysis on the economic benefits of offshoring. First of all, according to MGI, offshoring reduces labor costs dramatically. For example, the equivalent of a software developer who costs \$60 an hour in the U.S. costs only \$6 an hour in India. Similarly, a data entry agent who costs \$20 an hour in the U.S. costs only \$2 an hour in India. Furthermore, less desirable jobs in the U.S. are often seen as more desirable in lesser-developed countries. As a result, foreign workers are often more motivated and thus outperform their U.S. counterparts. In addition, companies are using a portion of the added savings as an opportunity to drive revenue growth. For example, by leveraging cheap labor, airlines are now more able to chase delinquent accounts receivables. Similarly, computer manufacturers are increasing market penetration by offering more services. As a result, by offshoring, many companies are creating far more value from increased revenues than from reduced costs.

U.S. businesses dominate the global share of offshoring, accounting for some 70 percent of the total market. Europe and Japan dominate the remainder, with the U.K. as a dominant player. Both the U.S. and the U.K. have liberal employment and labor laws, facilitating offshoring (MGI). There is potential to offshore a very wide variety of functions. The principal criteria for successful offshoring are that the functions can either be digitized or handled by telephone, and that appropriate skills are available or easily developed at the offshoring center. The first jobs to be offshored are lower value jobs such as call centers, back-end processing and accounting. But higher value work has since been added to the list. Examples include software maintenance and development, aerospace component design and pharmaceuticals research. As the chart below indicates, the range of jobs offshored successfully is substantial and widening continually (MGI).

As it stands, jobs are mostly offshored to countries where English is either the main business language or where there are large English-speaking populations. Thus Canada, India, Ireland, Israel, Australia, South Africa, and the Philippines have all proved particularly attractive. Offshoring is expected to grow at the rate of 30 to 40 percent a year over the next 5 years. Forrester, a leading analyst, projects that the number of U.S. jobs offshored will grow some \$136 billion in wages. Of this total, Forrester expects 473,000 jobs from the IT industry to go offshore over the next twelve years, representing 8 percent of all current IT jobs in the country, or 200,000 jobs a year (MGI). The chart below indicates primary offshored destinations worldwide, including the market share of the main job importing countries since 2001.

Given that the rate is likely to increase 30 to 40 percent over the next five years, we can adjust these numbers accordingly to obtain a more accurate estimate of the situation today in 2005. For example, assuming a conservative 35 percent growth rate, India, which carried 7.7 percent of the market in 2001, is likely to be carrying closer to 22 percent today.



As it stands, over the last two decades, in the wake of the North-American Free Trade Agreement (NAFTA) and the General Agreement on Tariffs and Trade (GATT), the U.S. has already shifted away from manufacturing toward what is now mostly a service economy. That is to say, 70 percent of the economy is now composed of services such as retail, restaurants, hotels, personal care services, construction, education and the like. These services are necessarily produced and/or consumed locally and therefore cannot be offshored (MGI). But offshoring most of the remaining 30 percent of the economy, would substantially increase the value of the U.S. economy as well as that of the importing country. The data suggests that \$1.45 to \$1.47 worth of value is created globally from offshoring every \$1.00 of U.S. labor costs. Of that total, the U.S. recaptures \$1.12 to \$1.14, while the receiving country captures, on average, 33 cents (MGI).

But completely converting to a service economy means not only a narrower array of career choices for Americans residing in the U.S., but also that many of the most desirable jobs will be among those no longer available. As chart, 1. above indicates this includes highly skilled and highly paid 'white-collar' jobs in the IT industry. Forrester now expects 3.3 million U.S. jobs will be exported by 2015, including software design¹⁰. In fact, Forrester also reports that 85 Indian software companies have already received a level 5 Compatibility Maturation Model Rat-

OFFSHORING OPPORTUNITIES ACROSS THE ORGANIZATION



ing (CMM) which is the highest rating. By comparison, only 42 other organizations worldwide have achieved that rating¹¹. Increasingly, as highly skilled workers become available in less-developed countries, most anything that can be physically accomplished at a distance, can be profitably offshored. This includes researchers, designers, data analysts, administrators, accountants, consultants, publishers, writers, and various management positions overseeing offshored functions.

Those who support offshoring might point out that the practice only represents a relatively small percentage of job-loss when compared to the total yearly turnover. But one must remember that offshored losses are likely permanent. As competition for white-collar jobs grows abroad, the bulk of jobs remaining in the U.S. will increasingly be limited to those requiring face-to-face interaction. Even this currently modest rate of loss markedly limits the future career prospects of today's U.S. high-schoolers and substantially increases their anxiety about finding a career with any future.

Unfortunately, a hard look at the facts reveals that the wealth created from offshoring does not entirely offset the hardships it creates for many of those affected. According to the Bureau of Labor Statistics, from 1979-99, 31 percent of jobs displaced by trade were not fully reemployed. While some workers were able to find higher-paying jobs, most did not. The statistics reveal that 36 percent of displaced workers soon found jobs that matched or increased their wages, but 55 percent reached no more than 85 percent of their former wages. And as many as 25 percent saw pay cuts of 30 percent or more (MGI). A partial solution commonly offered to this problem is a government or business-funded insurance program that would cover wage loss for reemployed full-timers and cover 70 percent of wage loss and full medical benefits during unemployment for up to 2 years. It is estimated that such an insurance scheme would cost no more than 4 to 5 percent of savings¹². Still, this would not necessarily fully compensate offshored workers since they may never succeed in obtaining equally rewarding work at equivalent pay. In addition, there are the intrinsic hardships of forced career change to take into account, such as insecurity, time, effort, and costs associated with choosing a new career and obtaining the requisite level of employment, which for the white-collar sectors are substantial. Imagine the difficulty of, say, a middle-aged parent going back to college for another graduate degree while living on a diminished income, then searching for a job two years later, still having to pay-off the college loan. These are real stresses, indeed struggles, to be incurred broadly across the middle class. But offshoring advocates such as Diana Farrell, President of MGI, sternly reply that globalization demands that we embrace lives of constant retraining. "We live in an economy of not only change," she says, "but of ever-more rapid change, and the expectation that you can hold one job for 20 years is not a realistic expectation."¹³ One cannot help but wonder if she will feel the same when her own consulting job is outsourced to an economist in India. Even if she herself is able to retire comfortably at that point, the market result may seem like a raw deal to newly minted American BAs in economics, unless of course they're open to making the transition—to India.

This is certainly a very demanding, indeed even altruistic, economic ideology. But looking back over all the data provided, there seems to be precious little to reproach it on purely utilitarian grounds. Summing up, offshoring increases global economic value, thus creating jobs for those who need them. Although most of the job creation is abroad and comes at the expense of domestic job losses, new domestic jobs in non-offshorable service sectors will eventually be created to compensate for those

losses. Furthermore, according to utilitarianism, all interests should be considered equally. So assuming sweetened severance packages including extended unemployment and health insurance is granted to offshored American workers, offshoring would indeed seem to achieve the greatest good for the greatest number. Utilitarianism demands that we be completely impartial to the best total balance of pleasure over pain. So if the total measure of happiness in the world can be increased by certain people sacrificing some of their own happiness, the result is entirely acceptable. Since the sacrifice in this case is rather significant, offshoring is not a moral duty. But it would seem nevertheless to maximize utility given the general circumstances above-mentioned.

The Goal of Genuine Impartiality

Rawls insightfully demonstrates, in *A Theory of Justice*, that utilitarianism "mistakes impersonality for impartiality"¹⁴. What he means by this is that instead of defining impartiality, as utilitarians do, from the perspective of a sympathetic observer of everyone's interests, one should define it from the perspective of the persons themselves with their own individual preferences, in an original position of equality. Only then can genuine impartiality be achieved by guaranteeing that no individual will have to bear a greater sacrifice than absolutely necessary for the establishment of a just society. Thus, according to Rawls, utilitarianism impersonally overlooks and subordinates individual preferences in favor of the greatest total balance of pleasure over pain. According to Rawls, this mistake happens because of the utilitarian assumption that the only way everyone's moral judgments can be brought into agreement is through our natural capacity for sympathy. As he puts it "the approvals of the impartial sympathetic spectator are adopted as the standard of justice, and this results in impersonality, in the conflation of all desires into one system of desire"¹⁵. This conflation, he argues, is irrational and unfair, for it would never be freely agreed to by anyone from a genuinely impartial standpoint of self interest, that is, before knowing what specific socioeconomic position one may actually end up in.

If we apply this standard of impartiality to the case of offshoring, we immediately arrive at some interesting results. Imagine being in the Rawlsian 'original position' of determining the norms of a just society, i.e. its social contract, not knowing what particular socioeconomic status one's fortune will bring. From this standpoint, everyone would make sure to set up a society in which no one would be more disadvantaged than absolutely necessary to insure equal opportunity. Inequalities would thus be allowed so long as they worked to the greatest interest of the least advantaged, by for example, instituting differentials on the basis of merit. Now, imagining oneself in this position, Rawls would ask if anyone would welcome being born at random into a society such as ours in which the dramatic aforementioned offshoring trends occurred? In other words, would a rational self-interested person prefer to randomly enter at birth into a society identical in every way to ours, but one in which such trends did not occur? If we think seriously about the economic hardships, the instability and the insecurities incurred broadly across the middle class from lives of constant retraining, I think it's quite clear such a prospect would be rather unappealing. Indeed, it becomes apparent that the utilitarian goal of greatest global growth disproportionately benefits a smaller number of upper-class stockholders at the expense of a much larger number of working-class stakeholders facing the prospect of job-loss. And

as for poor families that will benefit from lower priced goods, they would clearly trade that in for a more secure professional future, especially since it is mostly their less desirable jobs which are ripe for offshoring.

A utilitarian is likely to reply at this point that this thought experiment conveniently excludes consideration of those workers abroad who stand to benefit from offshoring. If we imagined the possibility of being born into the current global situation in which more jobs are created overall, we may in fact agree that this benefit is worth the social costs of constant retraining, even if they are ultimately incurred worldwide. In other words, a person facing the prospect of being born randomly into an underdeveloped job-importing country such as India may accept the costs of living a life of constant retraining as outweighed by a higher chance of escaping poverty. This is where the social contract theorist (or contractarian) parts company with the utilitarian. A contractarian considers it entirely irrational not to root rights and obligations in a collective social contract by, for, and of, a community of litigants. For it is only in the interest of collective agreements and enterprises that any institution is founded. Thus, the institutions created in the interests of a given nation are entirely beholden to the citizens of that nation. Accordingly, individuals and organizations within a nation participate according to a legitimizing collective social contract. Hence we erect public and private institutions entirely on the basis of national interest. The taxes we pay to fund education, infrastructure, private enterprise, etc. are provided exclusively for us—not for any other people. It therefore would seem absurd to turn over any and every offshorable job, which may often be quite desirable, over to the citizens of another country which have not participated in the slightest in the establishment of the network of social institutions necessary for the creation of those jobs. Rawls invites us to imagine the following example involving two different societies evolving over time:

*The first decides to industrialize and to increase its rate of real saving, while the second does not. Being content with things as they are, and preferring a more pastoral and leisurely society, the second reaffirms its social values. Some decades later the first country is twice as wealthy as the second...should the industrialized country be taxed to give funds to the second? According to the duty of assistance (in extreme cases of suffering) there would be no tax, and that seems right; whereas with a global egalitarian principle without target, there would always be a flow of taxes as long as the wealth of one people was less than that of the other. This seems unacceptable*¹⁶ (my parentheses).

So similarly, citizens of an industrialized society such as ours should not have to sacrifice good jobs that their own labor and industry produced in the interest of citizens of a more pastoral society such as India's who chose¹⁷ not to industrialize. Indeed the hardships associated with offshoring are likely to be much more burdensome than a graduated income tax to help underdeveloped countries industrialize. Essentially, the U.S. people are under no obligation to increase the availability of good jobs in other societies, and especially not if doing so means offshoring as much as 30 percent of the GDP, much of which is produced by chosen white-collar careers. If this seems to violate strong utilitarian intuitions, it is because those intuitions themselves are misguided. Again, quoting Rawls:

A classical, or average, utilitarian principle would not be accepted by peoples, since no people organized by its government is prepared to count, as first principle, the benefits for another people as outweighing the hardships imposed on itself. Well-ordered peoples insist on an equality among themselves as peoples, and this insist-

*ence rules out any form of the principle of utility*¹⁸.

Thus, on this line of reasoning, the widespread discretionary practice of sending jobs overseas is entirely irrational and unjust. A Rawlsian contractarianism would therefore recommend that businesses themselves refrain from offshoring unless necessary to maintain commercial success, e.g., if no satisfactory or affordable workforce is domestically available. And if businesses did not act accordingly on their own, that government regulations should intervene to keep the trend from continuing.

The Capitalist Social Contract

Interestingly, the more socialist-leaning economies of Europe, unified by the Euro (the UK conspicuously excluded) have little or no share of the offshoring market. Naturally, those economies are much more regulated by the hand of government. One therefore might expect those governments to mutually chose to inhibit the export of jobs to other countries outside the European Union. And indeed, this generally seems to be the case at present. By contrast, the more capitalist-leaning economies of the world such as the U.S., the U.K. and Japan have relatively liberal trade regulations and are thus, not surprisingly, the leading exporters of jobs.

Now, if we agree with Rawlsian contractarianism that discretionary offshoring is unjust, how should the more capitalist-leaning economies of the world work to minimize the trend? Obviously, they could erect new regulatory measures such as implementing a tax on offshoring companies proportionate to the value of the labor offshored and revoke the right of those companies to count the costs of offshoring as a non-taxable business expense. But given the amount of value still to be gained from offshoring even under those conditions, it is doubtful the trend would subside. In any case, capitalism constitutes a social contract in which the major portion of the economy is in private hands. Thus, contrary to socialism, in which the government retains a significant degree of ownership of economic value, capitalism leaves ownership and hence distribution much more in the hands of the private sector. As a result, business has a much greater degree of responsibility to voluntarily uphold its obligations to the collective social contract justice requires. For if it does not meet this responsibility it risks inviting governmental regulatory controls that will diminish its autonomy and profitability.

Capitalism operates on the fundamental belief that business does not function in a vacuum. That is to say, what's in the interest of business is ultimately in the interest of the people. But this basic tenet must also be understood in reverse: What's in the interest of the people is also ultimately in the interest of business. Hence, it is a particularly demanding social contract that implies a high degree of trust. And so when that trust is broken on a grand scale, in the corporate accounting scandals or late or in the current offshoring race, it compromises the people's faith in capitalism itself. Therefore, the continuing legitimacy of the U.S. economic system rests to a great extent on its business leaders taking business ethics seriously, indeed perhaps more seriously than their European counterparts. This means getting in the habit of reconsidering policies such as offshoring that tend to contrast, more than reconcile, private interest and public good. At this particular point in time, it means being prepared to challenge prevailing assumptions at the heart of a corporate culture.

¹ Thomas Friedman, *The Lexus and the Olive Tree*, Anchor Books, New York, 2000, pp. 104-106.

² *Ibid.*, p. 112.

³ Peter Singer, *One World: The Ethics of Globalization*, Yale, 2002, pp. 106-149.

⁴ John Rawls, *A Theory of Justice*, Harvard, 1971, pp. 437-8.

⁵ *Ibid.*, pp. 67-8.

⁶ John Rawls, *The Law of Peoples*, Harvard, 1999, p. 40.

⁷ McKinsey Global Institute, "Offshoring: Is it a Win-Win Game?" McKinsey & Co., San Francisco, 2003.

⁸ Peter Singer, *Ibid.*, p. 157, and "Famine, Affluence and Morality," *Philosophy and Public Affairs*, I:2, 1972, pp. 231-32.

⁹ Hospitals and health-maintenance organizations are already doing so, according to Jared Bernstein, Senior Economist at the Economic Policy Institute. See Steven Greenhouse, "Retraining for What?: If You're a Waiter, the Future is Rosy," *New York Times*, *Week in Review*, March 7, 2004.

¹⁰ Steven Greenhouse, "IBM Explores Shift of White-Collar Jobs Over Seas," *New York Times*, July 2, 2003.

¹¹ www.forrester.com

¹² MGI and Kletzer and Litan, "A Prescription to Relieve Worker Anxiety," *Policy Brief 01-2. IIE*, February 2001.

¹³ Steven Greenhouse, *Op.cit.*

¹⁴ *Op.* 166.

¹⁵ Pp. 163-4

¹⁶ Rawls, *Ibid.*, p. 117.

¹⁷ It could be argued that countries such as India or China, which have been subject to repressive rule, did not in fact "choose" not to industrialize and are thus not responsible for their lesser prosperity. Although this may well be, Rawls does not consider this plight as a burden sufficient to constitute an obligation to assist by citizens of other more prosperous countries. Rawls does however claim that "well-ordered peoples have a duty to assist burdened societies" that "lack the political and cultural traditions, the human capital and know-how, and, often, the material and technical resources needed to be well-ordered" (*Ibid.*, p. 106). Thus, in extreme cases of suffering such as genocide or mass-starvation, there is indeed a n obligation to assist. But with respect to countries, such as India or China, that clearly possess the political and cultural traditions and the human, material and technical resources needed to be well-ordered, the peoples of more prosperous countries have no duty to assist. Indeed, if placed in the original position, it would seem inappropriate for anyone to will to be taxed or "outsourced" in favor of the citizens of an already well-ordered society not undergoing extreme cases of suffering beyond that country's own capacity to assist.

¹⁸ Rawls, *Ibid.*, p. 40.

Julian Friedland

405 E Oak St.
Lafayette, CO 80026
USA
303 665-5807
friedlandj@gmail.com

Julian Friedland has a Ph.D. from the University of Paris 1, Pantheon Sorbonne and has taught business ethics at the University of Colorado at Boulder, Metropolitan State College of Denver, and St. Cloud State University in Minnesota where he recently completed a visiting prof. contract.