Offshoring of services and the mounting challenge to the Washington Consensus

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Revision of the Washington Consensus, and its implication for the offshoring of services

Abstract

The ‘Washington Consensus’ is usually described as agreement by prevailing politic opinion centred on Washington on the desirability of free trade and a global economy open to the unrestricted movement of goods, services, and capital. The Washington Consensus was, however, always silent on the movement of labour because of popular opposition to immigration. Offshoring has seemed to reconcile the mobility of capital with the relative immobility of labour. In the past offshore outsourcing was focussed on manufacturing and the main impact in the developed countries was on unskilled jobs. Offshoring of services which has recently become much more prominent is different because it is often the more highly skilled jobs which are at risk. The paper surveys the changes and the growing unease amongst political elites in the United States, and the implications this has for international business.

Introduction

The expression ‘Washington Consensus’ has been at the centre of ideological controversy for such a long time that it is not surprising that the term has come to mean different things to different people, causing its original author, John Williamson (Williamson 1990), to distance himself from most interpretations. In 2003, he called it a ‘damaged brand name’(Williamson 2003) and in a more extended conference paper the following year he revisited his reflections when he coined the term in 1989, and identified the deviants (Williamson 2004). On one side, he rejects as ‘market fundamentalists’ the neo conservatives, the neo liberals, and generally all those advocating monetarism, supply side economics, and minimal government, while, on the other, he rejects the interpretation of leftwing critics that Washington Consensus refers to policy prescriptions ‘imposed’ by Washington on an innocently passive developing world.

Instead, Williamson reminds us that by Washington Consensus he merely referred to a list of ten economic policy reforms which he thought – at that time, in 1989 - commanded a degree of consensus “in the political Washington of Congress and… among.. . senior members of the administration and the technocratic Washington of the international financial institutions, the economic agencies of the U.S. government, the Federal Reserve Board, and the think tanks.” The list of ten policies included: fiscal discipline, reordering public expenditure priorities, tax reform, liberalising interest rates, a competitive exchange rate, trade liberalisation, liberalisation of inward foreign direct investment, privatisation, deregulation and property rights. This list was intended as a prompt to a line-up of distinguished authors who were invited to a conference to report on the extent to which such policies and their supporting attitudes were already successfully being put in place in debt-ridden Latin American countries. Williamson ruefully reflects that ‘universal convergence’ – a term proposed by a supportive colleague

- would have constituted less controversial terminology. Whether we use the term ‘convergence’ rather than ‘consensus’, it is striking that there has been little agreement on what was being advocated, and one author has likened the prescriptions of the Washington Consensus (for want of a better term) to the fads of the fashion industry (Naim 2000) (Marangos 2007) (Williamson 2007). However, whatever the disputes about policies and means, there remained a large degree of unanimity, in Washington and amongst academics and elite policy makers more generally about the desirability of the objectives and ends. It is this unanimity which, as we shall see, is in the process of unravelling.

Be that as it may, the purpose of this rewinding of the track to the source, is to establish that whatever our interpretation, right or wrong, the original list of policies, while undeniably having had the desired effect of freeing up international movements of goods, services and capital, (in short, globalisation) did not make mention of the one factor or commodity which commands our attention in this paper, and which I would argue, holds the key to understanding the present unease with the putative success of globalisation itself. This factor is labour.

Writing in the mid 1990s the noted development economist Robert Wade (Wade 1996) succinctly described the Washington Consensus thus:

> Reflecting the demise of Keynesianism and the ascendancy of supply-side economics in the US and some parts of Europe, the consensus—the ‘Washington consensus’, as it has been called—was based on the twin ideas of the state as the provider of a regulatory framework for private-sector exchanges (but not as a director of those exchanges), and of the world economy as open to movements of goods, services, and capital, if not labour.

The free movement of capital, and the goods and services resulting from its investment, clearly facilitated the expansion of international business. However, the relative immobility of labour was also a vital component of this growth of international business and trade. Because the movement of people was constrained, capital from the developed countries moved to where labour was available, mainly in the developing countries, and exported the bulk of the output back to its customers in the developed world. However, if labour had been mobile then it is not certain that this would have happened, certainly not to the extent that it has. Capital did the moving, because labour could not. Other factor costs and availability aside, there is no reason to assume that capital has a preference whether to employ labour at home or abroad. In fact, it is likely that managers, as distinct from capital, would prefer to produce, if not in their own backyard, certainly within their own country. Downwind of course, but within a familiar legal and cultural environment.

The reason for the immobility of labour lies not with capital, or even with the economic costs of establishing new infrastructure, but with democracy. Migration tends to be unpopular, especially when it is from alien places, and when the immigrants are likely to accept lower wages and conditions of work than domestic labour, and to put pressure availability and costs of housing a social resources. The White Australia policy was a product of nascent Australian democracy (Sammut 2005). Plantation slavery in the United States – a case of enforced mobility of labour - had its origins in the pre-democratic period and did not survive the rise of democracy and its putative victory in the American civil war. The failure of the Bush administration in June 2007 to get its immigration bill through Senate, resulting in a further erosion of political legitimacy, is yet another example of how sensitive an issue migration is. The bill was opposed in the senate from both the right and the left and aroused considerable popular feeling, so much so that "a flood of angry phone calls from opponents of the overhaul shut down the Capitol switchboard before the vote"(Weisman 2007).

Immigration into the developed countries continues, of course, but it is constrained and funnelled. Legal immigration is organised by government in such as way as to attempt to secure economic benefit by relieving skill shortages and bringing capital. Numbers are relatively low, compared with demand, and the channelling into sectors where there is perceived to be a shortage of skills in the domestic work force limits popular opposition. People who do see their job not under threat from migration tend to welcome 'Polish plumbers', at least in limited numbers (Green 2006). Illegal migration, despite the costs, hardship, and dangers often involved, is a subdued indication of how much unsatisfied demand there is.

If labour could not move, at least to the degree it, and employers, wanted, but capital and products could, then that appeared to provide a resolution of the issue. The result has been a massive shift of production (and the creation of new production) offshore from developed to developing countries, in particular China which has been labelled 'workshop of the world'(Zweig and Bi 2005). Japan has explicitly used its aid programme to facilitate the transfer of Japanese manufacturing offshore (Lincoln 1993). However, in general, market forces underpinned by the liberalisation exemplified by the GATT and subsequently the World Trade Organization, has been quite sufficient. This transfer of production occurred both for goods, and for services, albeit at different speeds, and modes. The transfer of production of services has crucially been enabled by developments in information and communications technology (ICT).

Off Shoring: the shift to services

The service sector has overtaken manufacturing and the primary sector combined in world production, contributing two thirds of world GDP (WTO 2006). However, world trade in services is still quite low compared to its importance in world production, partly because of continuing restrictive domestic regulations (particularly in public services such as health, utilities, and education) but also because of technical issues. Services were the last bastion to be opened up to free trade.

If outsourcing of manufacturing production can be considered a first phase in the globalisation of production, recent years have seen a significant move towards outsourcing of services. In 2004, the World Investment Report signalled the new trend in an appropriately entitled annual report: The Shift Towards Services (UNCTAD 2004). The statistics are indeed illuminating.

As a percentage of world trade the trade in services increased fourfold between 1984 and 2004 to stand at 20% of the total world trade. As a percentage of total stock of foreign direct investments, the service sector, in 2004, stood at 60% compared to 50% a decade earlier, and only 25% in the early 1970s, the increase being even more pronounced in terms of inflows, namely 67% of the total in 2004 (UNCTAD 2005: 97-98).

In fact, so evidently sea–changing are these trends, that the authors of the WIR report speak of a *tradability revolution*. They argue that from a technical point of view services, in the past, were the sticky point. They could not easily be traded, let alone traded across borders, because they were impossible to deliver across a distance, the services of hairdressers, and plumbers, being classic examples. But there were also a lot of services, especially information based services, that could not be traded because the information could not be stored, or transmitted rapidly or because of the habit of direct contact. Other services could not be even be turned into information. Digitisation is changing all that. Back office functions of any kind: accounts, logistics, data processing, drawing, testing and even R&D, all benefit from the use of ICT to codify, standardise and digitise, which in turn allows the production of ever more services to be split up, and fragmented into smaller components that can be located elsewhere to take advantage of cost, quality, economies of scale, and so on. As one writer put it : 'tasks that can be performed elsewhere are limited only by a manager's imagination' (Outsourcing: the myths and facts 2004). Such fragmentation exceeds that in manufacturing and therefore the possibilities for relocation are greater than anything we have witnessed before. Offshoring of services reflects the revolution in their tradability.

Offshoring, both of manufacturing and of services, and the interplay between the two, has had a number of global consequences but since it is in the United States that the Washington Consensus was created, and is sustained, it is the specific impact on America which is of most importance and relevance to us here. The impact may be roughly divided into two, the economic and the political.

The economic impact of offshoring on the US

Economically, offshoring has contributed to the burgeoning US deficit in trade in goods and services. The degree of that contribution is both uncertain, and partly masked because the increasing deficit in merchandise trade is to some extent offset by in increase in foreign income.

Table1: US trade 2005
US$ millions

	Exports	Imports	Balance
merchandise	905,978	1,735,061	-829,083
commercial services	354,020	281,168	72,852
goods and services	1,259,998	2,016,229	-756,231

Source: WTO Trade Profiles 2007

The deficit in trade in goods is also partly counterbalanced by a surplus in commercial services. However the trends shown in table 2 suggest that this offsetting is declining, presumably because of the increase in offshoring of these services. Imports of goods have grown twice as fast as exports of goods. The disparity in services is less (and services are still in surplus) but again imports have grown faster than exports; 1.3 times as fast over the decade.

Table 2: Trends in US trade, 1995-2005

Annual percentage change

Merchandise	
Exports	4
Imports	8
Ratio M/X	2
Commercial services	
Exports	6
Imports	8
Ratio M/X	1.3

Source: WTO Trade Profiles 2007

The offshoring of manufacturing has, been complemented, especially in recent years, by the offshoring of services, especially to India (Dossania and Kenney 2007); (Davies 2004) (WTR05 Offshoring 2005) (OECD_ITO 2006) (Parkhe 2007) (Vashistha and Vashistha 2006) (Kehal and Singh 2006). Offshoring of services to China is currently much smaller than to India but growing fast :

> The most dynamic export sector in India is information technology (IT)-enabled services for global companies, including call centers and software application, design, and maintenance. Such activities require qualified English-speaking labor, and India has an abundant, low-cost supply. The principal users of these services are U.S.-based global companies, but offshore software development contracts from Japan and Korea are expected to grow (Fujita and Hamaguchi 2006). Despite their dynamism, India's overall exports of commercial services ($40 billion in 2004) are less than those of China ($62 billion), although $17 billion of India's were in communications and software (arguably the high end of the sector), compared with China's $3.6 billion in software. However, both countries still have relatively small world shares (1.8 percent and 2.8 percent of world services exports, respectively).
>
> Services account for only 41 percent of GDP in China (even after the recent revaluation), compared with approximately 52 percent in lower-middleincome countries, and this leaves plenty of room for growth if Chinese service providers start to master global service technology in the same way they have mastered manufacturing (Winters and Yusuf 2007: 17).

Some economists take a sanguine view of US prospects. (Trefler 2005: 2) argues

> Service offshoring is currently small. As it grows it will undoubtedly have important effects on America. However, the real concern is that in the longer run of 10-20 years, Chinese and Indian exports will devastate the United States. This concern is misplaced for two reasons. First, it ignores the ironclad law of comparative advantage which states that no country can export all goods.

This may be so, but there is no guarantee that two, or more, countries may have advantage over such a range, and type, of product that the effect might be ‘devastating’(Grossman and Rossi-Hansberg 2006) (Markusen 2005). Ricardo argued that

> Under a system of perfectly free commerce, each country naturally devotes its capital and labour to such employments as are most beneficial to each. … It is this principle which determines that wine shall be made in France and Portugal, that corn shall be grown in America and Poland, and that hardware and other goods shall be manufactured in England (Ricardo 1821: ch7.11).

However, if money is included, then conceptually China and India together could ‘export all goods’ to the United States and import nothing in return except money in some form. It is inconceivable that things would come to such a pass, but America’s huge deficit in merchandise trade does suggest the ‘devastation’ can be deep and wide, and the ‘ironclad law of comparative advantage’ offers no impregnable defence as long as the US can sustain its balance of payments deficit (Wade 2007). There is much controversy on that sustainability (Karczmar 2004). In the first quarter of 2007 the large and growing deficit on trade in goods was partly offset by a small increase in surplus on services, confirming the importance, both financial and political, of trade in service to the US economy (U.S. International Transactions 2007).

Trefler does concede that ‘Unfortunately, the ironclad law of comparative advantage does not rule out the possibility that China and India will export high-tech goods and services to us, leaving Americans to mend the socks of Chinese business executives’. Nevertheless, he discounts this because ‘China and India are a long way from being the world’s innovation giants’. He is correct, but the question is, how far are they away? Will they catch up with the United States in innovation, and if so, when? Will they move from followers to leaders? Not surprisingly, there is considerable dispute about China’s ability to innovate, with echoes of previous controversy about Japan (Broken China 2007) (Motohashi and Yun 2007)

One indication of change in innovation capability is the provenance of utility patents (‘patents for invention’) filed in the United States over the last decade. In 1996, 44.3% of patents were of ‘foreign origin’ and by 2005 this had grown to 48.1% (*US Patent Office* 2005). Since according to the US Trademark and Patent Office ‘the origin of a patent is determined by the residence of the first-named inventor’, patents classified as of foreign origin may have been originated in the R&D centres of US corporations abroad. However, by the same token, US patents may lodged by foreign companies. Despite these definitional uncertainties it does seem clear that the US lead in innovation is being eroded, and quite fast.

Table 3: Domestic and foreign patents filed in US, 1996-2005

	1996	2005
Total	109,645	143,806
US origin	61,104	74,637
Foreign origin	48,541	69,169
% foreign	44.3	48.1

Source: (*US Patent Office* 2005)

What is also interesting is, who is doing the eroding? Japan remains by far the largest holder of US patents (Table 4) , followed by Germany, but the growth is coming from emerging Asia, especially India (997%) and China (774%).

Table 4: Foreign country of origin of US patents, ranked by change, 1996-2005
Excludes countries with less than fifty patents in 2005

Rank	Country	1996	2005	change (%)
1	India	35	384	997
2	China	46	402	774
3	Malaysia	12	88	633
4	Singapore	88	346	293
5	Hong Kong	88	283	222
6	South Korea	1,493	4,352	191
7	Taiwan	1,897	5,118	170
17	Germany	6,818	9,011	32
18	Japan	23,053	30,341	32

Source:(*US Patent Office* 2005)

The political impact of offshoring on the US

Politically, the impact has been mixed. Consumers have benefited from lower prices. Job losses, actual and potential, in goods (mainly manufactures) have been concentrated in low-skilled areas. People with low skills, especially in a lightly-unionised country such as the United States, tend to be politically inactive, inarticulate, and impotent. The loss of blue collar jobs may concern economists and public policy analysts, but it does not translate into electoral jeopardy for presidents and their parties. It is when the job losses move up the social ladder that we might expect more political impact, and this is what appears to be happening today.

A key indicator of what might be the beginnings of a sea change in thinking about free trade, was an article entitled ‘Pain From Free Trade Spurs Second Thoughts’ that appeared in the *Wall Street Journal* in March 2007 (Wessel and Davis 2007). Although the content of the article was important what was really significant was the publisher. There has been plenty of opposition to free trade over the years but the WSJ was an unlikely place to see doubts. The catalyst was a prediction by Alan S. Blinder that some 40 million American jobs were at risk, and that this was only the tip of the iceberg. Blinder was described as ‘Princeton University economist, former Federal Reserve Board vice chairman and perennial adviser to Democratic presidential candidates', and his ties with the Democratic Party took on special import given the swing to the Democrats in the 2006 mid-term election.

Blinder, who described himself in the past as a 'free trader down to my toes' (Wessel and Davis 2007), has published an article in the influential journal *Foreign Affairs* in 2006 on the impact of offshoring, and specifically that of the growth area, offshoring of services.(Blinder 2006). Blinder argued that offshoring was not an 'impending catastrophe' for America but did point out that the nature of the jobs at risk was changing, and with it the numbers potentially involved. Offshoring in the past has usually meant low skilled jobs but the key factor now was whether skilled jobs were internationally tradable, and in fact the more IT-related, and more skilled the job, the more likely it was to move. The hairdressers in America would stay employed, but an increasing number of skilled jobs will go offshore. Those Polish plumbers might not be able to ply their trade at a distance, but software engineers, be they Polish, Indian, or Chinese, can and do (Aspray, Mayadas, and Vardi 2006).

Offshoring and its mounting discontents

There is nothing sacrosanct or inevitable about offshoring. (Mol, van Tulder, and Beije 2005: 615), who specifically mention the case of ICT services in India, suggest that in general 'it is more appropriate to think international outsourcing in terms of a balancing act between international production cost advantages and domestic transaction cost advantages than as a performance-enhancing tool'. In other words, if the balance of costs changes, then offshoring loses its magic. To ascertain those costs in their entirety we can broaden the perspective to take in consumer reaction in one direction and the political and intellectual framework (the 'Washington Consensus') in the other.

Call centres have been moved back to home countries because of customer rebellion (Treanor 2007). Moreover, (Taylor and Bain 2005) argue that transferring call centres to India exacerbates the problems that management, and workers, face at home. More generally, (Schniederjans 2007) notes that outsourcing in the computer and ICT industry has high failure rates.

There are wider geo-political and strategic concerns. (Lei 2007) notes that outsourcing to fast emerging competitor countries such as China inevitably involves transfers of technology and process thus imperilling the long term strategic advantage of US firms. This can be set within the context of the growing American concern, even fear, of the rise of China both economically and in terms of geo-politics, from military and space capabilities through to softpower and diplomatic status (*China military power* 2007) (Kurlantzick 2007).

Concern about job loss is not confined to the United States, or the other developed economies such as Germany (Geishecker 2007). It also resonates in intermediate countries such as South Korea (Lee 2007). Doubts are raised in India itself (Anantula 2006).

The Washington Consensus under threat

The 'Washington Consensus' might usefully be considered to go beyond the international economic institutions and policy makers that (Williamson 1990) had in mind when he coined the phrase. It particular it can be considered to embrace that shared confidence across the Republican and Democratic parties, and the US political elite in general, that unrestricted free trade was good for America and for the world in general. This Washington Consensus is under threat and there is increasing talk of 'managing' international economic movement, especially of jobs (Ferrante and Hira 2005). There are many factors at work but the catalyst is services offshoring which potentially has a greater transformative effect than anything in the past. The loss of skills, especially to countries such as China which is increasingly seen as the major challenge to US hegemony has strategic implications (Lei 2007) (Sojourner (pseudonym) 2003).

However, it is the effect on employment which is likely to have the major impact, especially as America gears up to its presidential election (Jansen and Lee 2007). Job loss to foreigners may take two forms. One is where temporary migrants are allowed in to fill jobs for which, in theory, there are no suitable American candidates. These are workers on H-1B and L-1 visas and this merges into the increasingly acrimonious debate about migration (Constable 2007). The other is the topic of this paper, the transfer of the job, actual or potential, offshore (Brainard, Litan, and Warren 2005).

The two forms reinforce each other and the theme of unemployment, especially skilled, white-collar services unemployment, looks set to be a major issue in forthcoming American elections. The impact on large articulate swathes of the electorate whose allegiance may shift to those who offer them job protection, may be a persuasive argument for politicians already buffeted by the dilemmas of foreign policy failure in the Middle East (Toner 2007). Middle America has seen its income stagnate and job insecurity increase and politicians are looking for ways to tap into middle class ''suburban populism'(Leonhardt 2007). This loss of jobs on services is sitting on top of a previous wave of job loss in manufacturing. Moreover, the climate in respect of free trade is changing. Companies, such as Mattel, which had shifted much of their production to China, and other low-cost locations, are licking their wounds over health and safety issues (Story 2007). It is significant that US industry is now calling for Federal re-regulation in response to imports, especially from China (Lipton and Harris 2007).

Taken together, these discontents in America about free trade and capital mobility bode ill for the Washington Consensus. Many of the discontents have been around for some time, and have long been an issue on the left (Levinson 2007). What is happening now is that concern and anguish have moved into the mainstream. This movement is driven in large part by the offshoring of services and its impact on articulate and strategically influential middle class constituencies. ‘Concern and anguish’ have not yet reached the stage of an agonising reappraisal of free trade. However, as Harold Wilson famously observed, a week is a long time in politics, and we have a year until the next presidential elections. The underlying loss of competitiveness of much of the American economy, of which offshoring is one critical aspect, may generate political responses that challenge the Washington Consensus and so the way the world has been trading and conducting international business.

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