

WHY OUTSOURCING SCARES THE MIDDLE-CLASS?

JANUARY 10, 2005



DR. RAJEEV DHAWAN
DIRECTOR

ECONOMIC FORECASTING CENTER GEORGIA STATE UNIVERSITY

The election circus is over and while we are all geared up for the holiday season, the realities of everyday life are still with us. CNN's Lou Dobbs has been the self-appointed watch-dog on the outsourcing issue but he uses more rhetoric than economic logic to rail against its evils in his daily evening commentary. Let me add my two cents to this issue based upon my experience as not only an educator, mentor and advisor to my students, but also as a professional economic forecaster.

In the early 1990's I was a young graduate student at UCLA, pursuing my PhD in economics and financing it all as a teaching assistant. Wearing jeans, a t-shirt and a bit of pre-mature gray somehow made me approachable and believable to the young undergrad students in my introductory economics classes. California at that time was going through a brutal recession, and freshly minted graduates with just an economics degree, even those with a 3.5+ GPA, were not getting job interviews. I observed that students who had done something extra, such as a minor in business economics or accounting, or had summer internship experience, were getting bites in the job market fish pond.

When asked for career advice by students deciding upon a major, I would advise them to gain additional skills apart from a pure concentration in economics, thus making

themselves more marketable to prospective employers. Specializing in one white-collar area with some appealing appendages is a classic middle-class strategy. I followed it, so did my peers and our parents before us. This strategy has stood the test of time over many generations.

Can I give this advice now with the same degree of confidence? The answer is both yes and no, as you would expect from an economic practitioner. Yes, the basic advice that one should have multiple skills is correct. But what has changed is that, in only a decade, the traditional pairings we used to recommend won't work in this new era. Outsourcing has either taken away the pay-off or made this generations-old strategy very uncertain. This has happened so fast that, in less than a decade, young students and their parents are feeling adrift and scared by the speed of change.

First, let's examine the factor responsible for this dramatic change, and only then can a solution be found. The chief culprit is modern communications technology, which spawned the great 90's, and at the time made us a richer and better-paid nation as a whole. But it also took away what I term the *geographic insulation* from the labor market. This term is better understood with the help of the following example.

In the 1950's an accountant in LA faced competition from accountants in neighbor-

ing cities but didn't have to worry about an accountant in NY taking away clients that easily. The cost of travel and communications protected each accountant's domain, allowing them to earn a very good living. In business lingo there was a premium, or pricing power, in the profession. Local supply and demand regulated this premium from getting too high. As communication costs came down in the 70's and 80's, especially with the advent of the fax and the emergence of private express carriers, the accountant in NY was now effectively competing with one in LA. The result was that we paid lower prices for our accounting work but still there was enough of a salary premium left for us educators to advise our students to become accountants. Thus, while Florida may have been cheaper than Wall Street for back-office operations, it was still in the same country. The competition was within the different geographical middle-class sections within the country.

But things started to change in the mid-1990's. In spring of 1997, I remember co-teaching an MBA class at UCLA where we asked our students what it would take to move back-office operations to India. The answer was surprisingly simple: feasible but costly given that satellite communications would take a decade to pay off. The reality is that the internet, email, and powerful but inexpensive software made this both cheaper and feasible by the end of 1990's.

Now, the competitor to an accountant at home is anyone, anywhere in the world with a high speed hookup, decent knowledge of English, an accounting major, and a US intermediary firm to facilitate orders. Today the premium for this profession for garden-variety accounting work is totally gone. (Sarbanes-Oxley requirements, however, have recreated the geographic insulation premium again for auditors). You can extend this analogy to other professions as well. The radiologist has been rendered obsolete or over-paid as a doctor in India can read an exact digital copy of your xray for 1/10th the price, and is faster to boot. An economics graduate in Shanghai can do research on Chinese issues more easily and cheaper than the economics major in Atlanta because of the native language advantage, plus users say

that the quality of work is superior. The list goes on and on.

The dark under belly of technology is the uncertainty of the future economic prospects of the middle-class when deciding to gamble with higher education. This is the classic risk versus return trade-off in finance. First, when blue-collar workers lost their price premium from global competition, the middle-class sat by smugly, comfortable in their white-collar strategy. But now, the middle-class's own (programmers, engineers) have produced the means for their own fear and discomfort, appearing in the blink of an eye in terms of generational time.

So what is my recommendation to a young kid and their parents? Think outside the box. This means pairing specialties that parents previously looked down upon. If that radiologist in their down time can also do book-keeping or marketing for the hospital then they will never be outsourced. Why? Companies outsource functions only when revenue growth is weak, as is the case since 2001 and that puts pressure on profit margins. The middle-class, also being the owners of those companies, is demanding a good return on their investments, as they should. If the person can fulfill more functions for the same price, and is in-house, I doubt any company will go looking for outsiders that easily, be they in Nebraska or in India, given the economies of scale from in-house management. We need to radically change our thinking - quickly - before we go the way of dinosaur.

One final thought. Until recently, I assumed that an MBA with concentration in pure finance still had a high price premium. In a recent speech to a group of CFO's of mid-to-small-sized banks I explained my double-duty concept with the radiologist example, and one CFO asked me if I knew of an MBA who could also program in C++ as it was too costly and inefficient to go to IT guys to program his complex finance formulas! The era of thinking outside the box is already here, and the middle class better adapt fast or the plight of the textile worker will become its new song.