

# Outsourcing and State Contracts

## What is Outsourcing?

The practice by which American businesses subcontract certain tasks to low-cost developing countries is known as “outsourcing” or “offshoring.” By pursuing profit maximization, firms remain competitive. A variety of jobs are being outsourced, including routine office work, computer-related work, business (accounting and finance), architecture, legal, art and design, and sales. The availability of real-time information via the Internet, satellite and transoceanic communications allows businesses to be sustained instantaneously around the globe. New information technologies let fewer people do more work and also help quickly bring new skills to learners everywhere.

Outsourcing uses the basic principle of comparative advantage. As long as there are workers elsewhere willing and able to perform the same work for less pay, U.S. firms will increasingly examine outsourcing as an option to hold the line on costs and remain globally competitive. Although this initially was unwelcome news to U.S. workers whose jobs will be lost, history suggests that this phenomenon will also generate many better, higher-paying jobs at home. The ability for the United States to maintain its competitive advantage in innovation is essential. Entrepreneurship and innovation depend on a broadly educated workforce committed to continuous learning and risk-taking.

## State Procurement

Using taxpayers' money to send work, and therefore jobs, overseas has come under attack in many of the states where such offshore outsourcing practices have turned up. At least forty-one states are parties to contracts that allow for work to be outsourced. Washington State is no exception.

Although controversial, the advantages to allowing states to contract with parties that may ultimately outsource some or all of the work should make critics pause. For instance, Washington State taxpayers most certainly enjoy a cost savings, freeing up more money to fund critical state services. Enacting anti-outsourcing legislation runs counter to the duty to taxpayers. The responsibility of Washington state government is to provide the highest-quality services to its citizens at the lowest feasible cost to taxpayers.

Moreover, the global economy operates both ways. Washington is one of the most trade-dependant states in the nation. Placing anti-outsourcing restrictions on state contracts could stunt positive interaction with foreign trading partners and result in potential retaliatory consequences. Many leading industries from all parts of Washington rely on overseas markets to remain profitable: airplanes, apples, beef, financial services, forest products, potatoes, heavy trucks, software, and wheat. Enacting anti-outsourcing legislation could encourage our trading partners to close their markets. Fewer international sales opportunities for Washington companies mean fewer jobs for Washington workers – many of whom provide economic support to families and communities.

## **Impact of Outsourcing**

In June, 2004, the U.S. Department of Labor (Department) reported that only a tiny fraction of workers hit by mass layoffs earlier this year lost their jobs because of "offshoring." According to the Department's study, less than 2 percent of workers affected by extended mass layoffs lost their jobs due to the shift of work outside the country. This data reflects current information, with data based in part on unemployment insurance claims. The sample reflected workers who were laid off at companies employing at least 50 workers, where at least 50 people filed for unemployment insurance during a five-week period, and the layoff lasted more than 30 days.

The report, issued by the Bureau of Labor Statistics, marked the first government effort to quantify the offshoring problem. Questions on job loss related to the movement of work were added to the Department's research program in January, amid nationwide concern about sending work abroad. The Department's report is consistent with an earlier report released by the U.S. Chamber of Commerce. The report concluded that, while there are various estimates on the number of jobs moved overseas, the actual number likely represents a very small percentage of workers.

## **What is Insourcing?**

"Insourcing" occurs when foreign-based companies "outsource" jobs to the U.S. This is a relatively common occurrence supported by a global market and positive relations with national trade partners. Insourcing illustrates that outsourcing is a two-way street. Millions of American workers are employed by foreign firms that outsource jobs to the United States. For example many foreign auto manufacturing companies have relocated to the U.S. As of 2004, Honda employed 24,000 Americans and is the largest single employer in central Ohio. BMW employs 5,000 in South Carolina alone. Toyota will soon open a new plant in San Antonio, adding 2,000 new jobs to the 33,000 Americans the company already employs. In New York State alone, about 455,000 Americans work for foreign companies.

The impact of insourcing was noted in a study on outsourcing commissioned by the U.S. Chamber of Commerce in 2004. Among the study's key conclusions was that foreigners actually sent more white-collar office work to the U.S. than America shipped to overseas. In services particularly, insourcing beat outsourcing by nearly \$60 billion annually.

## **Legal and Constitutional Issues**

Legislators in many states have introduced bills to restrict overseas outsourcing, and legislation on the issue has also proliferated at the federal level. Consequently, questions have arisen as to whether these bills violate the U.S. Constitution or American obligations under international trade agreements.

Many experts have concluded that many anti-outsourcing bills raise several legal and constitutional concerns. For instance, prohibitions on state contract work being performed overseas are the most legally suspect category of proposed outsourcing legislation, since courts would likely find that such measures improperly intrude on the federal foreign affairs power and violate the U.S. Constitution's Foreign Commerce Clause. Moreover, state laws offering preferential treatment for in-state interests, though not outright prohibitions may also violate the U.S. Constitution.

Some bills that attempt to restrict or ban sending U.S. consumers' financial, medical, or other related personal information overseas may be unenforceable under the doctrine of preemption. They may also be unnecessary. Existing federal laws, including the Fair Credit Reporting Act, the Health Insurance Portability and Accountability Act of 1996, and the Gramm-Leach-Bliley Act of 1999, already address the treatment of certain types of consumer information and permit the sharing of consumer information among affiliated entities without regard to geography and provide mechanisms for recourse against U.S. corporations for failing to take appropriate measures to guard consumer information.

## **Recent Legislation**

**2007-08:** No Legislation Relating to this Topic

### **2006 Legislation**

**SHB 3160** - The bill would have required disclosure of offshore outsourcing information in state personal services, purchased services, and civil service contracts. It also would have created exemptions for certain services contracts, including those where the Director of the Office of Financial Management determines that the only practicable location in which the services may be performed is clearly and justifiably outside the United States. SHB 3160 died in the Appropriations Committee.

### **2005 Legislation**

**HB 2144 – Regulating state contracts.** This proposal would have required the governor, in consultation with representatives of state agency management and labor, to develop and implement procurement policies and procedures necessary to determine whether a particular contract is in the state's "best interests." This bill was dead-on-arrival due to practical problems with its potential implementation. It was subsequently replaced with HB 2257.

**HB 2257 – Requiring state contracts to be in the state's best interests.** This bill also propose the "best interest" concept (see HB 2144 above) and , like HB 2144, *did not* require the OFM to consider the economic benefits of outsourcing. HB 2257 passed the House but died in the Senate.

**HB 1724 – Requiring disclosure of outsourcing.** This bill would have required certain state contracts and subsequent contracts to disclose: (1) the locations, by country, in which work is performed outside the U.S.; (2) the nature of the work being performed outside the U.S.; and (3) the percentage of the work being performed outside the U.S. HB 1724 did not pass the House.

**HB 1725 – Prohibiting the off-shoring of work under state contracts.** This proposal would have prevented work under state personal services, purchased services, and civil service contracts from being performed at locations outside the U.S. Only very narrow exceptions applied. HB 1725 received a hearing in the House Commerce & Labor Committee but subsequently died.

**SCR 8407 – Establishing a joint task force on state contracts performed, in whole or part, outside the United States.** This resolution creates a legislative task force and an advisory committee to study the performance and impact(s) of contracts performed outside the U.S. The findings and recommendations of the task force were reported to the Legislature on January 1, 2006. SCR 8407 was adopted by the Legislature. Final report issued 5/9/2007. Available online at <http://www.leg.wa.gov/documents/joint/SCTF/FinalReport.pdf>.