Thick as a (Campaign) Plank

U.S. Leaders Either Don't Understand or Prefer Not to Understand the IT Outsourcing Crisis, So Here's the Cliff Notes Version

By Robert X. Cringely

Last year, I wrote a pair of columns on information technology outsourcing to countries like India, suggesting that the practice was generally not a good idea. It was a smokescreen for age discrimination, and was not in the long-term interests of either the American employees or their companies. Then in my 2004 predictions column, I said that this outsourcing or offshoring or whatever you want to call it would become an issue in the coming Presidential election.

Now, I'm taking this opportunity to frame the debate more fully because, frankly, I hate to be wrong.

In the 1950s and '60s in England, there was a phenomenon they called the "brain drain," which was the mass emigration of scientists and engineers to the United States. The U.K. was still suffering from World War II, which had a much greater effect on that country's economy than on that of the U.S. Americans and even many younger people from Britain have little understanding of how difficult it was for that country to recover after the war. The war ended in 1945, but food rationing continued in some form in the U.K. until 1954, and foreign exchange restrictions remained in place well into the 1960s. The package holiday industry was invented solely because it was the only way to have a vacation in sunny Spain when you were only allowed to take £25 in cash out of the country. Against this austere economic landscape, America with its big cars and big salaries and technical industries with big ambitions looked to be the place to go. We as a nation benefited immensely from this migration as European science gave us the bomb and took us to the moon. Europe and the U.K., in turn, did not particularly benefit from this technical exodus, which hurt their local industries and local economies.

That was then and this is now, and while America remains a country of great technical capability, that capability is being compromised by a new kind of brain drain as we simply allow our local industries to fall apart. Send enough technical work to India or China, and what once was the engineering department ends up working down at Home Depot. The industries that are being particularly affected are information technology, telecommunications, and aerospace. These are also the only U.S. industries that in the 1990s produced substantial trade surpluses. We are shipping overseas the only manufacturing work that still makes money for America.

There are those who argue that the numbers involved are too small to worry about. What do a few thousand engineering jobs matter? These people simply don't know how thin the engineering talent is in many companies. Take 100 programmers out of any software company short of Microsoft or IBM ,and you've crippled some program and maybe the whole company. And the same is true for most of these other critical industries where big work is typically done by small teams.

Who wants this? The government of the United States doesn't want it, at least not in principle. The various state governments absolutely don't want it. The employees don't want it. The only groups who really want this are investors and top management—two groups that have the shortest time perspective, thinking no further ahead usually than the next financial quarter.

Shipping work overseas saves money that drops to the bottom line as profit. Stock prices are today keyed to earnings-per-share as is, to a certain extent, executive compensation. Now look at the average time that an institutional investor actually holds a given stock. This can be measured in months, sometimes in weeks, but hardly ever in years. So the investor timeline is short and the CEO timeline—with average tenancies in those positions at less than five years—is not much longer. So offshoring works great for these two groups. The stock goes up and along with it, the CEO's bonus and stock options. By the time the long-term effects of this policy are felt, both the investors and the CEO are long gone. And even if the CEO is still around, it is with a golden parachute negotiated long before that often pays him more to go away than he might have got to stay.

There is another component to this story and that is the role of multinational companies, offshore companies, and the international flow of capital. Big business tends to take a global look at these issues. They may have more and more workers in India, but those workers are still with the company, right? So what's the big deal? Earnings may be down in the U.S. but maybe they are better in some foreign division. And just maybe that foreign division is separately incorporated in a country that taxes business income at lower rates than in the U.S. or maybe not at all. Hey, that can only be good for earnings, right?

But it isn't good for local taxes in my community and maybe yours. We have what appear to be higher corporate earnings accompanied, for some reason, by lower tax payments. The same businesses that complain about a lack of local technical training aren't generally paying their share for that training. And subjects like music and art that we studied in public schools are generally long gone simply because there is no longer the money to pay for them.

It would be one thing if this was only an American phenomenon, but it is not. There is an economic pecking order in effect here. I'm living for the moment in South Carolina, which has America's only BMW manufacturing plant. That plant exists in part to build cars closer to their eventual owners, saving both time and money for transportation and import duty. But the plant also exists because the labor costs in South Carolina are dramatically lower than back in Bavaria. South Carolina offers greater labor flexibility (overtime, for one thing, is considered a good thing here while it requires special government permission in Germany), lower pay, lower benefits, and it is a heck of a lot easier to get rid of employees when they don't appear to be needed any longer. South Carolina is to BMW as India is to IBM.

None of this really matters when you take a truly global view. It only matters when you consider local implications. BMW building a plant in South Carolina does not appear to pose a risk that BMW know-how will be stolen and applied by some indigenous U.S. company ,but there are historical antecedents for just that. Nissan, the big Japanese car maker, got most of its technology in the 1950s from Britain, assembling Austin cars first from parts, then under license, and finally not at all—but you could still bolt a Datsun Cedric cylinder head straight on an MGB engine into the 1970s. Nissan is today in resurgence and British Leyland—the last incarnation of Austin—is dead.

Right now, Boeing is cutting jobs in Seattle and adding them in Moscow. This is certainly in the short-term interest of the company, but probably not in its long-term interest nor that of the United States, and certainly not the state of Washington, especially when Russian companies start competing with Boeing.

One could argue that this sort of transition is inevitable and we should simply roll with it. We can see in Asia, for example, a logical transition of industries from country to country as the cost of doing business rises with the standard of living. Japan in the 1950s had to switch from making textiles to chemicals because they simply couldn't generate enough revenue per square foot of factory space with textiles to support the local economy. So textiles moved to Korea. Then Japan couldn't afford to remain in the chemical business, either (for exactly the same reason) and moved up the industrial food chain to cars and electronics and eventually to semiconductors. Each time, the old industry moved to a place where business could be done cheaper, moving in turn to Korea, Malaysia, China, etc. This is a story of upward mobility, but what about what's happening in America? Our exports that have real value in the world are in IT, aerospace, telecommunications, medical technology, entertainment, and agriculture. Losing any of those becomes a story of downward mobility—a story that has already begun to be told.

Maybe we'll do what we've done before and reinvent ourselves. Just in my time in Silicon Valley, the place changed from apricots to transistors to computers to the Internet, each time finding a new way to make money. This was possible because of a unique convergence of labor and capital. Well, the capital is still there, but the labor is leaving, and with it not only a way of life, but also a way of livelihood for much of a nation. What happens when we are down to just entertainment and agriculture? Will BMW even need an American plant then?

I am not advocating protectionism, just prudence. Our economy is in a transition that our leaders choose to ignore. I'm not only unsure how any of the candidates come down on this issue, I am unsure whether they even understand the issue. And the same goes for the current administration in Washington.

We are making short-term decisions that are not in the long-term interest of our nation. Maybe those decisions are inevitable, but I'd like to understand what it is that makes them so. Because from my calculations covered in previous columns, the savings isn't really there at all.