OUTSOURCING TO LATIN AMERICA AND THE CARIBBEAN

Creating a Strong Regional Economic Block

By producing in Brazil, IBM forecasts a 10 to 15 percent decrease in sales prices to consumers and a 20-day reduction in delivery time of their new notebook computers. These reductions in price and delivery time are a direct result of outsourcing, or more precisely *"offshoring"* the manufacturing of the notebooks to Salectron, a Brazilian-based manufacturer. In an effort to continue these reductions, IBM is planning to increase its Brazilian-based operations by moving the production of ThinkPad notebooks to the Salectron facility.

Is this an example of economic openness and globalization? Yes. The gains in productivity realized at IBM can be taken as evidence of functioning markets and increased international economic liberalization.

Is this something that makes some American politicians uncomfortable? Yes! Outsourcing and its impact on the U.S. economy have become a hot issue in the current political climate. Politicians seeking election (or re-election in some cases) in November have begun using outsourcing as a major platform to attack their competitors and frighten voters into supporting them. Even television personalities are joining the debate (most notably Lou Dobbs of CNN's Lou Dobbs Tonight); regardless of how out of line they may sound!

The truth is simply that outsourcing does more good for the economy than it does bad; as supported by empirical studies conducted by The Cato Institute, The McKinsey Global Institute, Forrester Research, and others. Unfortunately some jobs are lost as a result of this process, and the elimination of these jobs can be painful to those whose jobs are displaced. In the end however, more jobs are created by our ever churning economy than are lost because of outsourcing.

A recent report by the McKinsey Global Institute estimates that every dollar the United States moves offshore brings America a net benefit of $1.12 to $1.14 back to the U.S. (in addition to the benefit to the country receiving the investment). The report projects savings to the U.S. economy of $390 billion by 2010 due to outsourcing. McKinsey reasons that as low value added jobs go abroad, labor and investment can switch to jobs that generate more economic value[1].

In an article published by the Wall Street Journal on February 12, 2004, Gregory Mankiw, Chairman of the Council of Economic Advisers, indicated that the movement of some service jobs "is probably a plus for the economy in the long run… Outsourcing is just a new way of doing trade." In the same article, Janet Yellen, Chief Economist to President Clinton, stated that "I agree with Greg's thrust. In the long run, outsourcing is another form of trade that benefits the U.S. economy by giving U.S. cheaper ways to do things." And her sentiment is common among leading economists.

They believe that outsourcing can be viewed as a stage in the natural progression of a competitive free economy. From this, outsourcing's theoretical origin's can be traced back to Adam Smith,

[1] "Offshoring: Is It a Win-Win Game?" McKinsey Global Institute, August 2003.

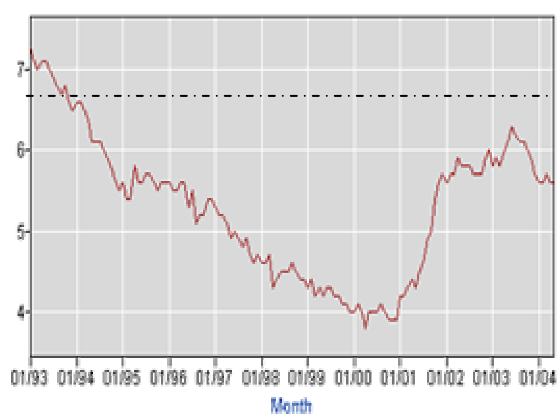
the father of modern economics. In *The Wealth of Nations*, Mr. Smith's most famous publication, the concept of the division of labor is first formally mentioned. This idea states, in simple terms, that workers can improve their productivity if they specialize in the tasks that they are best suited to perform, i.e. if an absolute advantage is present. This idea was later built upon by David Ricardo to form the theory of Comparative Advantage. In this instance, the division of labor can be thought of as a theoretical justification for outsourcing, in that the division of labor not only applies to the different parts of a manufacturing process, but can be related to all elements of the production of goods or services.

In approaching the issue of outsourcing from a geopolitical standpoint, and therefore by somewhat lessening the need to achieve the lowest costs of production or service; it can be argued that in order to create a strong regional economic block of the Americas, multinational companies must have the ability to compete against already established economic regions like Asia. One way to strengthen the Americas position is for American firms to consider outsourcing their needs within their own hemisphere to Latin America and the Caribbean (instead of China or India).

The motivation for this statement is three-fold, first LAC is a region that can yield economic benefits comparable to those normally associated with other countries where outsourcing has traditionally occurred. Second, outsourcing in LAC may allow companies to deliver products or services of equal or higher quality for relatively lower prices. Third, and finally, conducting business with LAC is consistent with an imminent demographic change taking place in the U.S., where Spanish will be as widely spoken as English in the next decades. In the past U.S. companies may have overlooked the opportunity to invest in Latin America. Today, however, the social and economic possibilities presented in LAC are far too great to go unnoticed.

The U.S. government appears to agree with the aforementioned reasons to consider working in, and with, LAC. Evidence of this is their attempt to negotiate and strengthen commercial ties with the region by promoting the integration of American markets through bilateral and regional trade agreements. Some of these agreements, like NAFTA (North American Free Trade Area), have already begun to payoff and may be indicative of the success of others to come.

In the ten years following NAFTA's inception, the total value of goods and services exchanged between the United States and Mexico almost tripled, from $81 billion to $232 billion. NAFTA has also encouraged higher regulatory standards in Mexico and more cross-border cooperation on sensitive environmental issues. Moreover, it is in the U.S.'s best interest to be aligned with stable, democratic and modern states, and through NAFTA, Mexico is closer to becoming one. Because of this, it is possible that other nations may follow Mexico's lead, assuming that the proper labor and commercial standards are upheld. Finally, and perhaps most importantly, there has been no "giant sucking sound" of jobs and investment heading south, as Ross Perot had forecasted. In the past decade, the U.S. economy has added a net 18 million new jobs and the U.S.'s unemployment rate is actually lower today than it was in the year



before NAFTA went into effect.

The previous graph, obtained from the U.S. Department of Labor depicts the U.S. monthly seasonally unemployment rate from 1993 (prior to NAFTA) to May 2004. From it we can appreciate that the previous statement is in fact true[2].

Nonetheless, even if one buys the geopolitical rationale to encourage outsourcing to Latin America and the Caribbean in an effort to create a strong globally competitive regional block in Americas, sound business practice, and traditional economic theory, tell U.S. that business will shift to produce (service) in countries economies where they can achieve the lowest producing costs (all other things constant), therefore it is vital to remark what exactly Latin America and the Caribbean can offer U.S. companies relative to countries like India and China. We believe the region put forward the following:

- Similar time zones: This might benefit communication between U.S. companies and their sourcing partners.
- Some countries are dollarized which facilitates payments and decreases currency risk issues.
- Over the last years vast government reforms projects financed by the Inter-American Development Bank and other multilaterals, have modernized and made more efficient governments and government processes.
- Improving infrastructures. Ports and roads networks have drastically improved.
- Close physical proximity to the U.S. that can meet ever-increasing just-in-time inventory requirements.
- Some countries are one flight away from major U.S. cities. Panama, for example, has daily flights to New York, LA, Houston, and Miami.
- Most countries have stable and open democracies.
- Cheap workforce.
- Language: Spanish speaking population is the largest majority in the U.S.; English is widely spoken in some Caribbean countries and in most Spanish/Portuguese speaking countries as a second language.
- Business ownership. You can own 100% of your business in most LAC countries.
- Cultural similarities.

Like IBM in Brazil, other companies will benefit from outsourcing in the Latin America and Caribbean Region. In doing so, those companies will help to promote and develop the economies in the western hemisphere, and contribute to the formation of a solid regional economic block.

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[2] http://data.bls.gov/servlet/SurveyOutputServlet

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