

GLOBAL SOURCING BACKGROUND

Global sourcing is the practice of locating operations around the world in the most productive and economical fashion. This practice has met with opposition from some policy-makers because they equate it with losing jobs locally. However, when the economics of global sourcing are reviewed, it is a win-win scenario for Minnesota and the world.

Global sourcing is not a one-way street. Jobs are created in the United States and jobs are eliminated here because of global sourcing. On balance, it is a net benefit to the United States and Minnesota. According to a March 15, 2004, Wall Street Journal report, in 2003 the United States posted a \$53.6 billion surplus in the trade of services. That means that more work is being sourced to the United States than away from it. In addition, according to the Department of Employment and Economic Development, more than 80,000 Minnesotans are employed by foreign-owned firms. This investment directly benefits Minnesota through wages paid to employees and the goods and services they purchase.

The Information Technology Association of America commissioned Global Insight to study the impact of sourcing IT software and services outside the United States. It concluded that the cost savings associated with global sourcing in the IT sector lowers inflation, increases productivity and lowers interest rates, which leads to higher levels of business and consumer spending and economic activity. Global Insight also estimated the impact on Minnesota. The study concluded that Minnesota employment and gross state product were higher in 2003 - and will continue to be higher in 2008 - because of global sourcing in the information technology industry.

The Global Insight study is consistent with the United States having a surplus in the trade for services, the employment created because of foreign investment into the nation, and the anecdotal information gathered by the Star Tribune in its September 5-7, 2004, series on "outsourcing." It documented that a local manufacturer with operations in China still employs a significant and growing number of Minnesotans because the Chinese operation allows it to keep making a product that was not profitable when being made in the United States. The jobs that remain in Minnesota are highly paid engineering and science jobs. Another company indicated that it would not be in business if not for global sourcing.

The McKinsey consulting firm also analyzed the impact of global sourcing on the economy. It concluded that for every \$1 of global sourcing activity, the United States captures \$1.12 to \$1.14 of the value created. The value comes from reduced costs that result in savings to customers and investors, new revenue from the export of U.S. goods and services, repatriated profits back to the United States and redeploying labor to more productive activities.

In a 2005 study "US Offshoring: Rethinking the Response," McKinsey concludes that legislation preventing offshoring deprives high-wage economies like the United States of several benefits. First, savings from offshoring can be reinvested in the company to develop next-generation technologies which creates jobs at home and abroad. Second, global competition improves the performance of companies. It cites as an example U.S. call centers. They improve their performance because they have to compete with call centers from India. Third, preventing offshoring will likely result in retaliation. Since the United States has a trade surplus in services, it has the most to lose from if companies stop purchasing services performed by U.S. companies.

Global sourcing also benefits the country into which the investment is made. It increases living standards of foreign countries and the ability of foreign citizens to purchase U.S. goods and services.

2004 legislation. In 2004, the Legislature debated whether to prohibit the state from contracting with companies that used global sourcing strategies or prohibit such firms from receiving state and local grants/loans. The Minnesota Chamber opposed the legislation because the impact on Minnesota employers, workers, economy and taxpayers was not well understood and there was a question about its constitutionality. As discussed above, global sourcing has economic benefits to Minnesota and the United States; however, these benefits are not understood by many policy-makers or the general public.

The constitutionality of the bill is questionable. In 1996, Massachusetts passed a law prohibiting state agencies from purchasing goods or services from companies doing business with Burma. The U.S. Supreme Court ruled in *Crosby, et al. v. National Foreign Trade Council* that the law was unconstitutional. Article II, §2, clause 2 of the U.S. Constitution gives the power to make treaties dealing with issues such as international trade solely to the president with the advice and consent of Congress. The court stated in *Crosby* that "This clear mandate and invocation of exclusively national power belies any suggestion that Congress intended the President's effective voice to be obscured by state or local action." For that reason, we believe this legislation would be unconstitutional.

Foreign countries would also likely retaliate and prohibit Minnesota companies from providing them with goods and services. After Massachusetts passed its "Burma law," the European Union and Japan lodged a formal complaint against the United States in the World Trade Organization, claiming that the law violated provisions of the Agreement on Government Procurement. Since all of our trading partners are not signatories to the agreement, retaliation is likely even if there is an exemption for businesses located in signatory countries.

Governor Pawlenty's action. Governor Tim Pawlenty signed an executive order to address state contract issues related to global sourcing. The order allows state agencies to consider where the work will be performed when determining the "best value" for the state in awarding contracts. It also requires vendors to disclose the location where services will be performed and receive approval before a change in location can be made. The order establishes a program to promote state contracting opportunities to Minnesota employers and directs the Department of Employment and Economic Development to promote the use of Job Opportunity Building Zones to businesses creating or expanding services that are commonly sourced outside the United States.

2005 legislation. In 2005, the Legislature debated call center legislation that was supported by the Communications Workers union. The legislation, as introduced, allowed individuals that receive telephone calls from or place calls to a call center to: (1) know the identification of the city, state, and country where the call center is located; (2) know the name or registered alias of the call center employee; (3) know the name of the employer of the call center employee; and (4) speak to a qualified employee of the company with whom the person is doing business. In addition, the legislation prohibited any financial, credit or identifying information to be sent to any foreign country without express written permission of the individual. An amended version of the bill revised the latter requirement so an employer that used a call center in a foreign country would have to, upon request, reroute the call to a call center in the United States before any financial, credit or identifying information is given. The legislation was designed to make it more difficult for employers to use foreign call centers. The legislation made it to the floor in the Senate, but no action was taken. In the House, the bill passed the House Commerce Committee and was referred to the Public Safety Policy and Finance Committee.

2007 legislation. In 2007 call center legislation was introduced that required a call center to identify where it was located if a Minnesota resident asked for the information. It also required foreign call centers to transfer calls back to a U.S. call center if requested and the option existed. The legislation included the language the business community negotiated with the authors in previous years. While those changes improved the bill, the business community still opposed the bill because it created operational problems for call centers, would likely result in customer inconveniences, and most likely violated U.S. trade agreements. In addition, the proponents of the legislation argued that it was needed to protect the disclosure of personal information. This is simply not true. Under current state and federal laws, U.S. businesses and their third-party contractors are required to maintain the same high information security standards regardless of the call center location.