Fairness, Globalization, and Public Institutions

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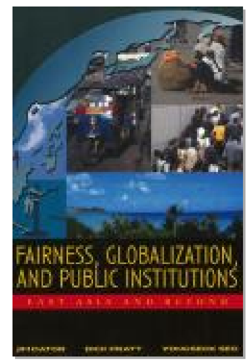

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ently in different situations. The state, like the globalization phenomenon, can work for either good or ill with respect to people's welfare. See Dick Pratt's Further Thoughts, "The Contested Terrain of Outsourcing," below.

Conclusion

This chapter has ranged rather widely. But that seems consistent with this volume's themes. Economists sometimes feel like the (barely) tolerated party guest at such meetings. Some of us see our role as telling rude truths; others may see us as merely rude. Yet as I hope these discussions on fairness, equality, globalization, and the role of states suggests, the sometimes bizarre economic perspective on the world can offer thought-provoking insights. Perhaps that is why a few of us keep getting in the door.

Further Thoughts

The Contested Terrain of Outsourcing

Dick Pratt

"Outsourcing" is the word used to refer to the process by which a product or service once done within a firm is done somewhere else. Until fairly recently a word unknown to most Americans, it has become an everyday part of our language.

Outsourcing first gained visibility in the United States as a domestic process in which a large producer would elect to use smaller, highly specialized firms to produce things it would be less cost effective to handle internally. The automobile industry provides a good model of this. The major producers obtained critical parts of their cars from firms with which they subcontracted.

In more recent times outsourcing moved from firms within a nation to firms in other countries. The motivation was of course cost savings, and the primary sources of these savings were cheaper wages, fewer health and safety rules, and lax environmental laws. Global outsourcing has turned what began as a trickle of unskilled work into a torrent. That torrent now carries much more than unskilled jobs from one place to another. India currently is the beneficiary of professional work that requires masters' and doctoral degrees. Americans who had felt they or their children would obtain secure, high-paying jobs if they achieved higher education now are uncertain. This uncertainty has done as much as anything to force Americans to think differently about globalization's effects.

Today the largest recipient of outsourcing from the United States is China. Consumers in the United States have come to expect that many of the products they buy from well-known American firms will carry a note informing them that although the product was created in the United States, it was produced in China. Despite being commonplace, it still can be a surprise, as when the small American flags that appeared everywhere to show national unity after 9/11 were found to be "Made in China."

In addition to being a torrent, outsourcing also has the quality of a set of dominoes. As the current recipients of outsourcing become prosperous, they also become more expensive relative to other places. In a globalized world, they fall as desirable production sites. In China today, for example, production is moving from the now more costly urban areas to the cheaper cities and towns in the interior. There is no reason to expect it won't later move to other countries.

Each fall of the domino, from internal outsourcing to cross-national outsourcing, from one global location to another that has become relatively less expensive, raises a basic concern in the places left behind. The concern is about the net effect, and it is this: will enough jobs be created to make up for those that are lost?

Most mainstream economists argue that this process reflects the market flexibility that is necessary to use resources efficiently and thereby to create the greatest aggregate wealth. They argue that in the long run there will be a net gain. Real people, of course, are confined to living their lives in the short run. The social and political, if not economic, question therefore is whether this domino process will create, in a short-enough run, sufficient jobs.

The public institution equivalent of private-sector outsourcing is most commonly referred to as privatization. Privatization means that a service once performed by a government agency is now delegated to a private firm. Trash collection, public transportation, and prisons are all examples in the American context. Some government agencies send their services to other jurisdictions, such as one state sending prisoners to another where there is more capacity.

The exporting of public-sector jobs abroad is a noteworthy recent development. Food stamps is an example. A state agency contracts with a private company to provide services to food-stamp clients, and that firm subcontracts with a foreign firm in order to reduce costs and increase profits. This practice raises some interesting issues for taxpayers and their elected representatives. On the one hand, costs are reduced, which might help to contain or reduce taxes. On the other hand, jobs funded directly by taxpayers are going abroad.

Privatization has been a contested process in most places because of three issues: the loss of government jobs that have better pay and benefit packages, questions about the areas where private firms in fact cannot be more cost efficient, and the likelihood that private companies will ignore due process or access and equity values and policies that are built into public organizations.

A new term has appeared to cover what once was referred to only as "privatization." Public Private Partnerships (PPPs) points to the complex relationships that have developed around certain kinds of services. A government agency (or agencies) still authorizes and funds the service, but it is provided through a network of private-for-profit and private-nonprofit entities. This might be the case, for example, in the area of drug prevention and treatment.

PPP networks raise a number of challenging, and interesting, issues. Are the relationships so complicated as to be more inflexible than the bureaucratic apparatus they replace? What new skills do public servants need to learn? What will be the political dynamics of the networks? How is public accountability maintained? Can the public purposes that created the network be maintained over time?

Notes

1. As a brief introduction, see Allan M. Feldman, "Welfare Economics," in *The New Palgrave, A Dictionary of Economics,* ed. John Eatwell, Murray Milgate, and Peter Newman (New York: The Stockton Press, 1987).

2. For a brief description and review of the early literature, see Hal R. Varian, "Fairness," in *The New Palgrave, A Dictionary of Economics,* ed. Eatwell, Milgate, and Newman.

3. The ideas reviewed here developed in at least two independent strands. Confusingly, different terminology for similar ideas has persisted. William J. Baumol developed these ideas in a book-length treatment, providing applications to policy issues. Baumol's preface amusingly recounts his "invention" of the "superfairness" theory, only to quickly discover the emerging literature in the area. See William J. Baumol, *Superfairness* (Cambridge, Mass.: MIT Press, 1986).

4. Thomas L. Friedman, *The Lexus and the Olive Tree* (New York: Anchor Books, 2000), 105.

5. Richard Katz, *Japan, The System That Soured: The Rise and Fall of the Japanese Economic Miracle* (Armonk, N.Y.: M. E. Sharpe, 1998), 102–106.