

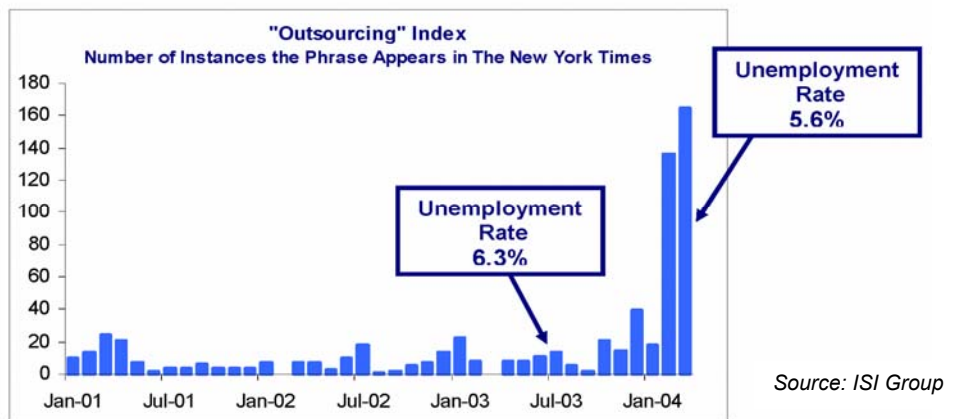
# The Offshoring Debate

**Ben Hock, Managing Director and Senior Investment Officer with A I M Capital Management, Inc., provides insight into the politically charged discussion of offshoring U.S. jobs.**

A relatively sluggish recovery in the labor market during the most recent economic cycle has led to much debate regarding the future of the American worker. Doomsday reports suggest that employment in this country as we know it is about to cease due to a practice known as “offshoring,” or outsourcing certain jobs to workers overseas. Due to ever-increasing globalization, critics say, American jobs are being snatched up by the millions by impoverished foreign workers willing to endure sweatshoplike conditions at one-third of the salary expected by American workers. Indeed, the employment situation and the subject of offshoring have become ripe for the picking by many politicians, who decry the practice and have pledged to fight against it with protectionist policies designed to penalize “Benedict Arnold” corporations that send jobs abroad.

Simplifying the issue into clever catch phrases does little to insure American jobs or to address the economic realities of competition in the global marketplace. It is a subject more aptly suited to higher-level economics curriculums than opinion pages; however, a closer look at some typical misconceptions about offshoring should provide clarity on an issue more often characterized by hyperbole than logic.

Dynamic market forces over the past 30 years have resulted in structural changes to the economy. A shift from a manufacturing to a service-based economy, globalization and the rapid expansion of the information technology industry have contributed to these changes. Free trade agreements such as The North American Free Trade Agreement (NAFTA) have not only encouraged trade of goods, but also services, which include jobs. The Internet has changed the way we live and work, allowing people to communicate without regard to geography. Countries that were once isolated from free trade can now participate in the global economy, as their citizens become technologically savvy.

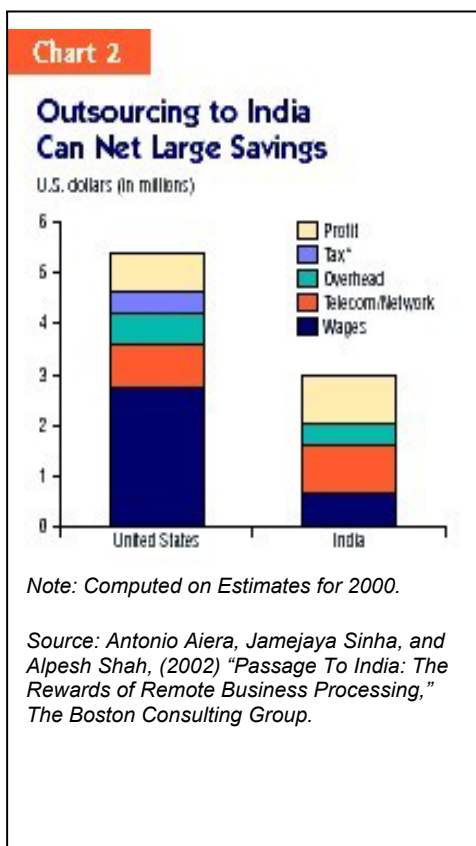
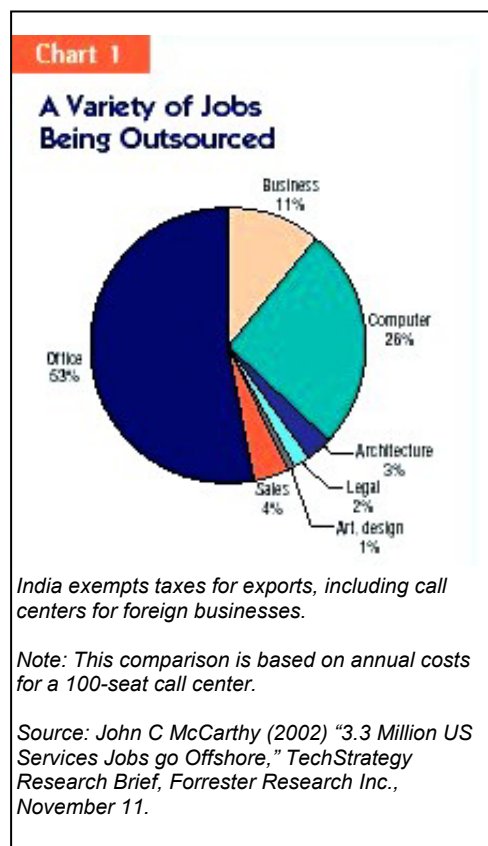


Corporations, seizing this opportunity, have sent jobs abroad to Mexico’s maquiladoras and India’s call centers. Alarmist reports suggest that workers in these countries are somehow being exploited as hapless

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victims of the globalization machine. In reality, these very jobs, often derided for their low wages and poor working conditions, may be helping to lift developing countries out of very poor, subsistence-level, agrarian economies and into a capitalist system. It appears the “low wage” jobs for the average foreign worker provide a much higher quality of life than traditional rural jobs of the past, much like the transformation that took place in the United States in the early 20<sup>th</sup> century. Companies who have outsourced some of their more routine jobs have been derided, even labeled traitors. Politicians have gone as far as to threaten legislation to protect American jobs from going overseas. However, this legislation, which is in essence a subsidy, might be short sighted, handicapping companies’ ability to compete globally and profit at home, and ultimately hurting consumers and taxpayers in the form of higher prices. Such protectionist rhetoric was often used in opposition to NAFTA, which evoked fears of a “giant sucking sound” due to the potential loss of American jobs. In fact, since NAFTA took effect in 1994, the U.S. went through the largest economic expansion in its history, and more than 2 million jobs were created during this period.



Protectionist measures ignore the effect that offshoring and free trade has on American soil. In recent years, foreign companies have outsourced much of their manufacturing production to the United States, for the same reasons American companies send jobs overseas. There are now roughly 6.4 million workers in the U.S.

directly employed by foreign firms, including more than 43,000 employed by Nestle, 35,000 by Toyota Motor Corporation, and 12,000 by Allianz Group. Foreign companies find

that it is cheaper to employ Americans to manufacture BMWs and Hondas here than in their home countries, due to the myriad of costly trade restrictions and employee regulations within their borders. Regardless of where they are domiciled, corporations that effectively manage costs add to their bottom line, which benefits shareholders and, in turn, consumers in the form of lower prices for goods and services.

It is possible that the number of potentially outsourced jobs is being overstated. Politicians, while on the campaign stump, have used estimates in the tens of millions; however, Forrester Research estimates that the number of outsourced jobs will be around 3.3 million by 2015. Forrester Research also concluded that only 300,000 of the roughly 2.7 million job losses in the last few years have been a direct result of

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outsourcing. The rest of the job displacement has been a result of very strong productivity gains throughout the recession and recovery period.

Furthermore, it does not appear that outsourcing has caused irreparable damage to the labor market. Unemployment has decreased to 5.7%, down from a high of 6.3% in June 2004, and manufacturing employment has been improving. The Employer Outlook Survey by Manpower International, which gauges employers' hiring expectations, has been up for three quarters in a row, and the most recent survey hit its highest level since 2001. In March, nonfarm payrolls rose by 308,000, exceeding even the most bullish expectations.

In addition, demographic factors are already at work in the labor market, as baby boomers will retire in large numbers in the coming years, causing a massive turnover in jobs to a degree to which this country has never seen. Ironically, this has raised questions about whether there will be enough well trained Americans to fill these jobs. Out of necessity, corporations may look to offshoring as a way to offset the potential lack of applicants.

Percentage of employers who expect to hire more workers in the second quarter of this year:	
Construction	42%
Education	15%
Finance	23%
Manufacturing (durables)	31%
Manufacturing (non-durables)	27%
Mining	21%
Public Administration	21%
Services	30%
Transportation/Utilities	23%
Wholesalers/Retailers	30%

Sources: CNN Money, Manpower International

However, there is little question that some Americans will lose their jobs due to outsourcing overseas, and it will be bumpy in these circumstances, but we think temporary. As companies adapt to the ever-changing marketplace, new technologies and products will lead to the need for new jobs. This process of "creative destruction" is most disconcerting at inflection points in economic cycles, but the American economy has always provided abundant opportunities for its citizens.

In our opinion, an attempt to enact policies to artificially protect jobs would be little more than a knee-jerk reaction to a complex issue that is yet to be fully examined in the political realm. Such policies may create job security for some but at the potential expense of consumers and taxpayers alike. Offshoring is not a zero sum game. We may all be better off when countries become wealthy and self-sufficient, when corporations become

more efficient and profitable, and when innovation dictates our future. Just as American workers have continually moved from the farm to the factory to the office building, they will likely continue to adapt to the new and unknown opportunities that lie ahead. Americans will likely remain among the most highly trained, productive and innovative work force in the world.

**The opinions expressed are those of the author, and there can be no guarantee as to how markets will perform or how employment trends will behave.**

**Sources:** Federal Reserve Bank of Dallas, "Southwest Economy," Forrester Research, www.whitehouse.gov, CNN Money.com, BusinessWeek, Institute for International Economics, ISI Group, UBS Investment Research, McKinsey Global Institute, Fortune.

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