

**TO OFFSHORE OR NOT TO OFFSHORE:  
WHICH NATIONS WILL WIN A  
DISPROPORTIONATE SHARE OF THE  
ECONOMIC VALUE GENERATED FROM  
THE GLOBALIZATION OF WHITE-COLLAR  
JOBS?**

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## I. INTRODUCTION

A passionate debate is raging world-wide on what the impact will be from offshoring<sup>1</sup> white-collar jobs<sup>2</sup> on both developing and developed nations.<sup>3</sup> Anti-offshoring proponents fear that developed nations will be weakened by the loss of irreplaceable jobs and developing nations will be further exploited.<sup>4</sup> Offshoring proponents argue that a well-functioning, global free market will enhance company productivity and profits.<sup>5</sup> This will propel developing markets to open further and enable developed nations to use repatriated profits to expand their economies.<sup>6</sup> Although neither side has emerged victorious in the debate, the history of the industrial revolution suggests that market forces will cause offshoring to occur.<sup>7</sup> Indeed, the

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1. Offshoring is the movement of jobs by corporations from one nation to another in an effort to lower costs or improve service. See Dictionary.com, Offshoring, <http://dictionary.reference.com/browse/offshoring> (last visited Oct. 21, 2006).

2. White-collar jobs are defined as nonmanufacturing jobs that usually require a specialized knowledge base by the worker to complete the work. See Dictionary.com, White-Collar, <http://dictionary.reference.com/browse/white-collar> (last visited Oct. 21, 2006).

3. MCKINSEY GLOBAL INST., THE EMERGING GLOBAL LABOR MARKET 11 (2005), available at [http://www.mckinsey.com/mgi/reports/pdfs/emerginggloballabormarket/MGI\\_executivesummaries\\_offshoring.pdf](http://www.mckinsey.com/mgi/reports/pdfs/emerginggloballabormarket/MGI_executivesummaries_offshoring.pdf) [hereinafter MGI LABOR MARKET]; Adam Mordecai, Comment, *Anti-Offshoring Legislation: The New Wave of Protectionism the Backlash Against Foreign Outsourcing of American Service Jobs*, 5 RICH. J. GLOBAL L. & BUS. 85–89 (2005); Uday Karmarkar, *Will you Survive the Services Revolution?*, HARV. BUS. REV., June 2004, at 101; Thomas J. Manley & Scott M. Hobby, *Globalization of Work: Offshore Outsourcing in the IT Age*, 18 EMORY INT'L L. REV. 401, 401 (2004).

4. See MGI LABOR MARKET, *supra* note 3, at 11–12; *Offshoring: India Still Ahead*, ASIA TIMES ONLINE, May 26, 2004, [http://www.atimes.com/atimes/South\\_Asia/FE26Df03.html](http://www.atimes.com/atimes/South_Asia/FE26Df03.html); Karmarkar, *supra* note 3, at 101 (“Service jobs are at risk in all developed countries.”); see also Mordecai, *supra* note 3, at 85–87 (explaining that white-collar jobs, once thought to be safe, are now vulnerable due to a decrease in technology costs).

5. See Mordecai, *supra* note 3, at 93–94.

6. MGI LABOR MARKET, *supra* note 3, at 11–12; Mordecai, *supra* note 3, at 94.

7. Karmarkar, *supra* note 3, at 102 (detailing the globalization and offshoring of

technological advances in communication, the greater process commoditization, and the success of developing nations in improving the education level of their citizens suggest the time is ripe for offshoring white-collar jobs.<sup>8</sup> Major corporations see this opportunity “as both a ‘blessing and a curse,’ with the lure of cost savings tempered by the fear of deskilling.”<sup>9</sup> Yet by 2008, the demand for white-collar service jobs, once considered to be immune to offshoring, to be provided by low-cost developing nations is estimated to reach 160 million jobs (approximately 11% of the projected 1.46 billion service jobs worldwide).<sup>10</sup> Given that offshoring is occurring and will continue to occur, three key questions arise. Will the tactics of the debaters ultimately influence the amount of economic value that will be created?

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the manufacturing industry in the United States, and suggesting that it is an analog for the upcoming changes in the services industry); *see also* Mordecai, *supra* note 3, at 92 (comparing the current exodus of white-collar jobs in developed countries with the obsolescence of carriage-makers after the automobile became popular).

8. *See* Thomas H. Davenport, *The Coming Commoditization of Processes*, HARV. BUS. REV., June 2005, at 102 (detailing how and why companies are moving towards standardized processes); *see also* Karmarkar, *supra* note 3, at 101–03 (highlighting technology changes as the driver for the industrialization of services); *see* Manley & Hobby, *supra* note 3, at 402 (describing changes in technology as “[a] worldwide web of instant voice and data transmission . . . [that] has created a world wherein workers can be ‘virtually’ anywhere, access limitless information, and participate ‘real-time’ around the globe in the nearly instantaneous transformation of ideas into wealth.”); Justin K. Holcombe, *Solutions for Regulating Offshore Outsourcing in the Service Sector: Using the Law, Market, International Mechanisms, and Collective Organization as Building Blocks*, 7 U. PA. J. LAB. & EMP. L. 539, 546–47 (2005) (commenting about the rise in education levels in developing nations).

9. Press Release, Baker & McKenzie, Business Voices Concern that Offshoring Will Deskill British Workforce (May 18, 2004), *available at* <http://www.bakernet.com/BakerNet/News/Archive/offshoringandbritishworkforce.htm> [hereinafter Baker & McKenzie Press Release].

10. MGI LABOR MARKET, *supra* note 3, at 22 (estimating the demand for offshoring white-collar services from developing nations by analyzing eight representative sectors of the global economy). The eight sectors included: auto, health care, insurance, IT services, retail, retail banking, packaged software, and pharmaceuticals. *Id.* The demand for offshoring these sectors varied from 3% (retail) to 49% (packaged software). *Id.* The McKinsey Global Institute then extrapolated these eight sectors into the global economy in 2008 to determine the approximate demand for offshore services barring any constraints on supply. *Id.*; *see also* Karmarkar, *supra* note 3, at 102 (citing a World Bank study showing ten percent of jobs in the United States could be lost).

When will the value be created? And which countries will win a disproportionate share of the value?<sup>11</sup>

Nations that structure a win-win dynamic around offshoring, both internally and with other nations, will maximize the economic value they are able to capture. Two core elements of a win-win dynamic are: 1) a positive regulatory environment and 2) a growing body of successful offshoring deals.<sup>12</sup> Currently, these two core elements are at risk in many nations from both protectionist legislation that seeks to prohibit, or at least inhibit, offshoring,<sup>13</sup> and also from immature contracting capabilities, which fail to effectively structure and govern the deals.<sup>14</sup>

To address these risks and strengthen their win-win dynamic, countries should enact legislation that promotes open trade, spurs employment, and ensures that the quality of the services remains stable.<sup>15</sup> Additionally, companies should seek contracts to support their deals which are flexible enough to accommodate continuous improvement and evolution of the service, yet specific enough to enable appropriate governance and dispute resolution from a distance.<sup>16</sup> These

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11. See Karmarkar, *supra* note 3, at 101 (giving historical examples of protectionism debates, including the United States in the 1980's as a period when protectionism was challenged and "companies went into competitiveness overdrive" to rebound the economy, and the 1930 Smoot-Hawley tariff on imported goods as a time when protectionism exacerbated the Great Depression); see also Mordecai, *supra* note 3, at 88 (suggesting that globalization will "radically shift[] the balance of advantage from those who have traditionally wielded the power to new challengers").

12. See *infra* Part III-IV.

13. See generally Jennifer L. Dauer, *A Summary of Issues Raised in "Offshoring" Legislation*, 40 PROCUREMENT L. 10 (2005) (examining U.S. efforts to stop the outsourcing of government contracts).

14. See Linda Tucci, *Offshore Contracts: The Finer the Print, the Better*, SEARCHCIO.COM, Apr. 13, 2006, [http://searchcio.techtarget.com/originalContent/0,289142,sid19\\_gci1179934,00.html](http://searchcio.techtarget.com/originalContent/0,289142,sid19_gci1179934,00.html).

15. See, e.g., MCKINSEY GLOBAL INST., HOW OFFSHORING OF SERVICES COULD BENEFIT FRANCE 5-8 (2005), available at [http://www.mckinsey.com/mgi/reports/pdfs/offshoringbenefits\\_france/MGI\\_France\\_Offshoring.pdf](http://www.mckinsey.com/mgi/reports/pdfs/offshoringbenefits_france/MGI_France_Offshoring.pdf) [hereinafter MGI FRANCE] (analyzing the implications of offshoring on the French and German economies).

16. See *infra* Part IV.B. Governance for an offshoring relationship involves a multidisciplinary cross-organization committee which is responsible for monitoring and ensuring compliance with the contract and pertinent laws, as well as, evolving the relationship between the parties over time. See *White Water Outsourcing: How*

recommendations will lead to maximizing the potential win-win economic value of offshoring.<sup>17</sup> The faster countries succeed in achieving these two core elements of a win-win dynamic, the greater their share of the value will be.

This Comment will explore how countries can maximize their economic gains from offshoring by understanding their economic weaknesses, legislating strategically, and ensuring contracts are successful. Part II addresses the economics of offshoring and the implications for countries that purchase and supply offshore services. Part III will examine the existing and emerging national legislation and international treaties that will impact offshoring and make recommendations for improvement. Part IV will analyze why current intracountry outsourcing deals, a typical precursor to offshoring, have had execution difficulties and address how these lessons learned can be applied to enhancing offshoring contracts. Finally, Part V will summarize the findings and draw concluding recommendations.

## II. ECONOMICS OF OFFSHORING

Business strategy has been moving towards offshoring white-collar jobs such as information technology, finance, and customer service call centers for the last fifteen years.<sup>18</sup> The management fad of business process reengineering,<sup>19</sup> in the early 1990's, started companies down the path of consolidating these functions across multiple business units to gain economies

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*Outsourcing Helped to Save Williams*, GLOBAL HUMAN CAP. J., Oct. 5, 2006, <http://globalhumancapital.org/archives/115-White-Water-Outsourcing-How-Outsourcing-Helped-to-Save-Williams.html>.

17. See Simon Briskman, *Setting Standards*, OUTSOURCING INST., (2006) <http://www.outsourcing.com/content.asp?page=01b/other/oe/q605/settingstandards.html>.

18. See Mordecai, *supra* note 3, at 89–91 (providing a history for the development of service-oriented offshoring); Anne Krishnan, *White-Collar Jobs Once Outside the Global Economy Are Heading Overseas*, HERALD-SUN, Nov. 13, 2004, available at [http://www.citizenstrade.org/pdf/heraldsun\\_whitecollaroffshoring\\_11132004.pdf](http://www.citizenstrade.org/pdf/heraldsun_whitecollaroffshoring_11132004.pdf).

19. Business process reengineering is a methodology for improving the effectiveness of a business process by mapping the process, identifying inefficiencies, envisioning the ideal end state process map, and then implementing the new envisioned process. See SearchCIO.com, *Business Process Reengineering*, <http://searchcio.techtarget.com> (last visited Oct. 21, 2006).

of scale.<sup>20</sup> To be successful, processes were streamlined, standardized, and automated using customized or packaged software and work-flow tools like SAP and PeopleSoft.<sup>21</sup> Additionally, these processes were transformed into services, complete with charge-back pricing and leadership that was independent of the business unit to ensure maximum standardization and accountability.<sup>22</sup> Grouped together, these services often became known as shared service centers.<sup>23</sup>

Once well encapsulated, independent, and commoditized, the transition of these services to outsourcing was an easy management step to further lower costs.<sup>24</sup> Company leaders also saw it as a way to free-up leadership time and energy that could then be focused on the core functions that supplied their competitive advantage while at the same time locking in year-on-year cost reductions promised by the outsourcers.<sup>25</sup>

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20. See Davenport, *supra* note 8, at 101–02; MGI LABOR MARKET, *supra* note 3, at 12–14. See generally MICHAEL HAMMER & JAMES CHAMPY, REENGINEERING THE CORPORATION: A MANIFESTO FOR BUSINESS REVOLUTION 1–6 (1993); MICHAEL HAMMER, BEYOND REENGINEERING: HOW THE PROCESS-CENTERED ORGANIZATION IS CHANGING OUR WORK AND OUR LIVES 3–7 (1996).

21. SAP and PeopleSoft are enterprise software packages used to standardize and automate business processes. See Oracle.com, PeopleSoft Enterprise Applications: Oracle Products, <http://www.oracle.com/applications/peoplesoft-enterprise.html> (last visited Oct. 21, 2006); Sap.com, SAP United States — New Product Development and Introduction, <http://www.sap.com/usa/solutions/npdi/index.epx> (last visited Oct. 15, 2006).

22. Charge-back pricing is a type of funds transfer between business units within a corporation where the amount charged is based on reasonable market prices per unit and the number of units consumed by the business unit. Prior to the creation of charge-back pricing, companies often allocated back-office services based on headcount or revenues. See William P. McKinnon & Ernest A. Kallman, *Mapping Chargeback Systems to Organizational Environments*, 11 MIS Q. 5, 5 (1987), available at <http://www.jstor.org/view/02767783/ap010042/01a00050/0>.

23. A shared service center is an independent business unit with its own budget that provides services (e.g., human resources, finance, legal, facilities, IT) to the other business units within the corporation. See Answers.com, Shared Services, <http://www.answers.com/topic/shared-services> (last visited Oct. 21, 2006).

24. See Karmarkar, *supra* note 3, at 102–03 (detailing the strategic logic companies should consider when determining which services to offshore).

25. See Ann H. Spiotto & James E. Spiotto, *The Ultimate Downside of Outsourcing: Bankruptcy of the Service Provider*, 11 AM. BANKR. INST. L. REV. 47, 47 (2003) (defining “core competencies” that companies can focus on more when they outsource other functions). See International Association of Outsourcing Professionals, *Outsourcing*

Outsourcers achieved the cost savings by further consolidating these services across companies to gain even more economies of scale, by implementing technological innovations faster than the companies could have, and by locating them in low labor cost areas.<sup>26</sup>

The relative success of outsourcing has led many companies to become even more aggressive by “develop[ing] . . . new and more expansive models of outsourcing such as vertical outsourcing, Business Process and Business Transformation Outsourcing and the use of offshore companies to provide services at lower labor costs.”<sup>27</sup> The most lucrative trend in outsourcing is international outsourcing, defined as offshoring of services to developing nations as part of an international labor arbitrage strategy.<sup>28</sup> This occurs when services that are provided by a company or its outsourcer are transferred to developing countries in order to capture significantly lower labor costs for skilled work.<sup>29</sup> To understand the magnitude of this labor arbitrage opportunity, consider the example that “U.S.

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*Failures?*, FIRMBUILDER.COM, June 3, 2001, <http://www.outsourcingprofessional.org/firmbuilder/> (follow “Outsourcing Failures?” hyperlink) [hereinafter IAOP] (arguing that “[o]utsourcing is now the ‘preferred option’ over internal investments in non-core areas at many of today’s leading technology companies”); Mordecai, *supra* note 3, at 89; Holcombe, *supra* note 8, at 541-42.

26. See Davenport, *supra* note 8, at 102.

27. Scott W. Pink, *Recent Trends in Outsourcing: Understanding and Managing the Legal Issues and Risks*, 781 PLI/PAT 363, 366-70 (2004) (defining vertical outsourcing as focusing on serving a particular business process or regulation issue within an industry (e.g., Federal Energy Regulatory Commission (FERC) accounting for an energy utility)). Business process outsourcing is defined as occurring when an end to end process is outsourced (e.g., payroll). *Id.* Business transformation outsourcing occurs when a business process is dramatically improved to best practice levels because it is outsourced rather than just moved as a whole with different providers. *Id.* Offshoring is any type of outsourcing, but the service provider must be located in another country. *Id.* See also Karmarkar, *supra* note 3, at 103 (defining industrialization strategies for services which help select what type of outsourcing and offshoring model to apply).

28. See Wilhelm Kohler, *International Outsourcing and Factor Prices with Multistage Production*, ECON. J., Mar. 2004, at C166; Holcombe, *supra* note 8, at 546.

29. Holcombe, *supra* note 8, at 546; see MGI FRANCE, *supra* note 15, at 9 (providing a labor cost index chart for the average white-collar worker’s fully-loaded salaries across developed and developing countries).

architects are paid about ten times what architects in Vietnam are paid.”<sup>30</sup>

The acceptance of outsourcing and the movement towards offshoring has been staggering, leading one British corporate director to comment in an interview that “[offshoring is] an accelerating trend too – it used to be offshoring to manufacturing, but now it’s services, higher skills – it’s no longer just the trailblazers but also conservative companies.”<sup>31</sup> Gartner Group expects “that up to 80 percent of leading enterprises will include outsourcing in their business strategies by 2005.”<sup>32</sup> The United States accounted for \$101 billion in outsourcing revenue in 2000 and was predicted to grow to \$160 billion in annual revenue by 2005.<sup>33</sup> “A 2004 United Nations survey of Europe’s top 500 companies reported that, while nearly one-half of respondents plan to offshore more work in the next few years, fifty percent of European Union (‘EU’) jobs offshored thus far have gone to firms in other EU countries.”<sup>34</sup> Likewise, early adopters of offshoring are taking massive steps to capture the value. For instance, one survey found that “the world’s 100 largest financial services firms expect to ‘transfer \$350 billion of their cost bases abroad’ by 2008.”<sup>35</sup> Looking across all sectors of the economy, McKinsey Global Institute, in the most comprehensive and in-depth study undertaken to date, found that by 2008, the demand for white-collar service jobs to be provided by low-cost developing nations is estimated to reach 160 million jobs (approximately 11% of the projected 1.46 billion service jobs worldwide).<sup>36</sup> In sum, offshoring will have a

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30. Holcombe, *supra* note 8, at 546.

31. Baker & McKenzie Press Release, *supra* note 9 (analyzing in-depth, anonymous interviews with thirty-five FTSE 500 directors across a wide range of sectors in the United Kingdom).

32. Pink, *supra* note 27, at 365.

33. Jaikumar Vijayan, *Recession is Good for Outsourcing*, COMPUTERWORLD, Mar. 18, 2002, <http://itreports.computerworld.com/managementtopics/management/story/0,10801,69126,00.html>.

34. Manley & Hobby, *supra* note 3, at 404–05.

35. Aaditya Mattoo & Sacha Wunsch-Vincent, *Pre-Emptying Protectionism in Services: The GATS and Outsourcing*, 7 J. INT’L ECON. L. 765, 770 (2004).

36. See MGI LABOR MARKET, *supra* note 3, at 22.

dramatic influence on the economic landscape of many countries and companies for years to come.

A. *Why are Companies Offshoring?*

Multinational companies will be forced into offshoring over time to remain economically competitive.<sup>37</sup> For example, “[o]ne UK bank located more than five thousand jobs offshore between 2001 and 2003—and has generated annual savings in excess of 250 million euros. This reduced its cost-to-income ratio by almost six points.”<sup>38</sup> This degree of return can shift the company from being a laggard to being best in class for the industry.<sup>39</sup> Additionally, companies successful at offshoring will be able to reduce prices—further putting pressure on others to follow suit or differentiate themselves from their immediate competition.<sup>40</sup>

Offshoring generates economic value through three main sources: lower labor costs, improved productivity, and expanded scope of services.<sup>41</sup> The value that offshoring can potentially generate is tempered by backlash from customers, unions, and national governments, as well as by companies’ ability to successfully execute this business restructuring-type strategy.<sup>42</sup> Companies must address both issues.

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37. See Baker & McKenzie Press Release, *supra* note 9 (summarizing interviews of executives on the implications of offshoring for their businesses).

38. MGI FRANCE, *supra* note 15, at 11. Cost-to-income ratio is an efficiency measure for the banking industry defined as operating costs divided by net banking income. See Moneyterms.co.uk, Cost/Income Ratio, <http://moneyterms.co.uk/cost-income/> (last visited Oct. 21, 2006).

39. *Id.*

40. See *id.*; Diana Farrell, *Beyond Offshoring—Assess Your Company’s Global Potential*, HARV. BUS. REV., Dec. 2004, at 82.

41. See JOHN HAGEL, III & JOHN SEELY BROWN, THE ONLY SUSTAINABLE EDGE: WHY BUSINESS STRATEGY DEPENDS ON PRODUCTIVE FRICTION AND DYNAMIC SPECIALIZATION 37–39 (2005) (illustrating how offshoring can be used as a way to accelerate capability building). See generally Farrell, *supra* note 40, at 82.

42. MGI LABOR MARKET, *supra* note 3, at 11–12, 15, 25 (providing that companies that find offshoring difficult typically struggle with operational issues, management attitudes to offshoring, and structural issues); see also Jim Landers, *Offshoring Not a Panacea for Everyone*, HOUS. CHRON., Sept. 19, 2005, at D4 (giving example of how Dell has handled the backlash against offshoring by reframing their migration of work overseas as “allshoring”).

*B. Will Offshoring Improve or Hinder the Economy of a Developed Nation?*

For the developed countries who host the companies now purchasing offshore services, the passionate debate on what is in the nation's best interest with regard to offshoring still rages with good reason.<sup>43</sup> Studies by the McKinsey Global Institute find that given the current labor re-employment rates and the regulatory environment of a particular country, the economic value to a developed nation can vary from enhancing the nation's economy to weakening it.<sup>44</sup> According to the survey, the United States stands in the best position to win economically by capturing a disproportionate share of the value generated by offshoring.<sup>45</sup> McKinsey Global Institute's research results in 2005 found that "for every dollar of corporate spending on services that American firms move to India, the U.S. economy as a whole gains \$1.14 to \$1.17 in return."<sup>46</sup> The gains are directly derived from three sources: cost savings within U.S. companies, increased consumption by India of U.S. goods and services, and repatriation of profits from U.S. investments in India.<sup>47</sup> Beyond this, re-employment of displaced U.S. workers is estimated to generate an additional benefit of 57 cents.<sup>48</sup>

Three main drivers impact whether a nation's economy will grow or shrink as a result of offshoring: language constraints, ability to export and repatriate profits from offshore supplier countries, and re-employment rates.<sup>49</sup> First, language

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43. See MGI LABOR MARKET, *supra* note 3, at 11–12.

44. MGI FRANCE, *supra* note 15, at 5–6.

45. See *id.* at 5; MCKINSEY GLOBAL INST., OFFSHORING: IS IT A WIN-WIN GAME? 9 (2005), available at [http://www.mckinsey.com/mgi/reports/pdfs/offshore/Offshoring\\_MGI\\_Perspective.pdf](http://www.mckinsey.com/mgi/reports/pdfs/offshore/Offshoring_MGI_Perspective.pdf).

46. MGI FRANCE, *supra* note 15, at 6.

47. *Id.*

48. *Id.* Re-employment estimates are based on historical data that 69% of U.S. nonmanufacturing workers who lost their jobs due to foreign competition between 1979 and 1999 found new jobs within six months.

49. *Id.* at 7–9 (providing a chart to show the type of benefits available from offshoring for French, German, or U.S. economies); see also MCKINSEY GLOBAL INST., PERSPECTIVE: CAN GERMANY WIN FROM OFFSHORING?, June 2004, at 7–9, available at [http://www.mckinsey.com/mgi/reports/pdfs/offshore/MGI\\_Whitepaper\\_German\\_Offshoring.pdf](http://www.mckinsey.com/mgi/reports/pdfs/offshore/MGI_Whitepaper_German_Offshoring.pdf), [hereinafter MGI GERMANY].

constraints determine the places where developed countries may offshore.<sup>50</sup> Given major differences in the flexibility of the labor market and availability of new jobs within the developed country, the offshoring infrastructure within the developed country, and the cost of labor in the developing country, the impact on the overall savings and the success of the transition can be significant.<sup>51</sup> Unlike the United States, whose economy improves with offshoring,<sup>52</sup> other nations are currently not so lucky.<sup>53</sup> For example, France and Germany both lose potential economic value from offshoring.<sup>54</sup> France earns back only €0.86 for every €1.00 spent on offshoring and Germany only recoups €0.74 for every €1.00 it applies.<sup>55</sup> France and Germany are at a significant competitive disadvantage because there are fewer French and German speaking workers than English speaking workers in developing countries.<sup>56</sup> As a result, rather than offshoring to India or China, who have the largest pool of skilled workers and an established infrastructure for offshoring,<sup>57</sup> France and Germany often have to resort to less prepared and more expensive Eastern European and North African countries.<sup>58</sup> “While offshoring to India and China brings cost savings of 85 percent to 90 percent, offshoring to North Africa cuts costs by about 70 percent, and to Eastern Europe by just 55

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50. MGI FRANCE, *supra* note 15, at 6–9.

51. *See id.* at 6–8.

52. *Who Wins in Offshoring?*, CNETNEWS.COM, Oct. 26, 2003, <http://news.com.com/2030-1014-5096283.html>.

53. *See, e.g.*, MGI GERMANY, *supra* note 49, at 14 (citing that Germany’s case offers an example for why reform is required for other E.U. economies).

54. *See* MGI FRANCE, *supra* note 15, at 5–6.

55. *Id.* at 6–7.

56. *See* Thomas McLean, *The Offshoring of American Medicine: Scope, Economic Issues and Legal Liabilities*, 14 ANNALS HEALTH L. 205, 214–15 (2005) (discussing the obstacles language barriers pose to offshoring); MGI FRANCE, *supra* note 15, at 6–8; MGI GERMANY, *supra* note 49, at 6; Karmarkar, *supra* note 3, at 104 (noting that the locations chosen to offshore services will be different than those of manufacturing due to language barriers).

57. *See* MGI FRANCE, *supra* note 15, at 8; *cf.* Manley & Hobby, *supra* note 3, at 404–05 (stating U.S. companies have outsourced jobs to India (84%), China (45%), and the Philippines (26%)).

58. *See* MGI FRANCE, *supra* note 15, at 8; MGI GERMANY, *supra* note 49, at 6.

percent to 75 percent.”<sup>59</sup> Because several Eastern European countries have joined the European Union, fewer risks and constraints to offshoring now exist.<sup>60</sup> However, the cost of labor in Eastern Europe is still higher than other areas, and the infrastructure is not as mature as what the United States and the United Kingdom are achieving in India and parts of Asia.<sup>61</sup> This is causing German and French companies to save less and experience more implementation problems than other nations.<sup>62</sup>

Second, nations with language constraints are unable to use major export markets, like India and China, as their outsourcing partners; and as a result, are unable to extract a quid pro quo for placing their offshoring deals in these markets.<sup>63</sup> This impacts both the expansion of that nation’s exports and its ability to repatriate the additional earnings.<sup>64</sup> Since American firms now dominate high tech exports that are required to build the necessary infrastructure for offshoring, countries like Germany and France capture little of the value generated.<sup>65</sup> Additionally, U.S. companies have been more proactive in buying stocks or fully owning their offshoring partners.<sup>66</sup> As a result, more profits are repatriated back to the United States than other European countries.<sup>67</sup>

Third, a key economic difference lies in the limited ability of

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59. See MGI FRANCE, *supra* note 15, at 8.

60. See *id.* at 14 (discussing the offshoring benefits to France if a free trade area between the European Union, Mediterranean, and North America is created); Afzal Akhtar, *India Challenged! New EU Members Join the Outsourcing Race—India Still Has the Highest Offshore Location Attractiveness Index!*, INDIA DAILY, Sept. 27, 2004, <http://www.indiadaily.com/editorial/09-27f-04.asp>.

61. See MGI FRANCE, *supra* note 15, at 7–8 (explaining that the cost of labor is higher in Eastern Europe and North Africa, where France commonly offshores).

62. See, e.g., MGI GERMANY, *supra* note 49, at 6–8 (detailing the obstacles of offshoring for Germany and the barriers it must overcome to benefit from offshoring); MGI FRANCE, *supra* note 15, at 7–8.

63. See MGI FRANCE, *supra* note 15, at 7–9.

64. *Id.* at 8.

65. See MGI FRANCE, *supra* note 15, at 8; MGI GERMANY, *supra* note 49, at 8 (discussing the difference in the value gained by Germany from offshoring compared to the United States).

66. See MGI FRANCE, *supra* note 15, at 8.

67. See *id.* (“30 percent of the revenue of India’s offshoring industry is generated by foreign-owned (mostly U.S.) companies.”).

some developed nations' workers to become re-employed.<sup>68</sup> The United States currently enjoys approximately a 70% re-employment rate, whereas Germany's could be as low as 40%,<sup>69</sup> and France's is about 60%.<sup>70</sup> The net impact of this for Germany, for example, is that instead of making €1.05 at U.S. re-employment levels<sup>71</sup>, it only recoups €0.80 for every euro spent offshoring.<sup>72</sup> Likewise, raising the French re-employment rate to U.S. levels would add an additional €0.13, eliminating France's net loss.<sup>73</sup> The drivers for the lower re-employment rates include historic challenges, like the continued integration of East Germany into the German Federal Republic, and social policies that make the labor markets in Germany and France less liquid.<sup>74</sup> Germany also suffers from an "aging population and low birth rates [that] will reduce the total number of workers in the coming decades, making offshore labor necessary to supply the low-cost goods and services the country needs to maintain or improve its standard of living."<sup>75</sup> As a result, these countries must find a way to make offshoring a more viable option.

In response to the opportunity offshoring provides, developed nations should not allow the fear and initial results of offshoring to drive detrimental protectionist policies that will only lead to an ever shrinking national economy; rather, developed nations should use offshoring as a catalyst to drive structural changes.<sup>76</sup> Each of the three main drivers for impacting the value of offshoring should be pursued with vigorous national policies in order to enhance a country's

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68. See MGI GERMANY, *supra* note 49, at 9–10; MGI FRANCE, *supra* note 15, at 8.

69. See MGI GERMANY, *supra* note 49, at 9; see also Landers, *supra* note 42, at D4 (noting that the U.S. labor force has lost 5% to offshoring, yet created 5% in new jobs over the same period).

70. See MGI FRANCE, *supra* note 15, at 8.

71. See, e.g., MGI GERMANY, *supra* note 49, at 6–9.

72. See *id.* at 9.

73. See MGI FRANCE, *supra* note 15, at 8.

74. See MGI GERMANY, *supra* note 49, at 9; cf. MGI FRANCE, *supra* note 15, at 17 (recommending that regulations on working hours, minimum wages, and the hiring and firing of workers be relaxed in France).

75. MCKINSEY GLOBAL INST., *Can Germany Win From Offshoring*, July 2004, <http://mckinsey.com/mgi/publications/germanoffshoring.asp> (Web Introduction).

76. See MGI FRANCE, *supra* note 15, at 19.

opportunities.<sup>77</sup> Enhancing re-employment rates, shifting social policies, and legal reform are essential to a country's success.<sup>78</sup> Likewise, minimizing language constraints and maximizing exports and repatriation profits should be addressed by strategically teaming with nations that offer pools of resources meeting a country's unique language requirements through targeted infrastructure investments and free-trade agreements.<sup>79</sup> Each of these legal risks and opportunities will be addressed in detail in Part III of this paper.

### C. Will Offshoring Further Exploit Developing Nations?

Developing nations are scrambling to gain a piece of the offshoring pie. India and China have the most to gain because they have the largest supply of young university graduates that have up to seven years of experience.<sup>80</sup> Indeed, "India alone has nearly as many young professional engineers as the United States, and China has more than twice as many; China has twenty times the number of doctors as the United Kingdom . . . ."<sup>81</sup> However, twenty-six other countries around the world are also considered viable contenders in the frenzy to effectively offshore.<sup>82</sup> A study by AT Kearney compared the attractiveness of different countries for offshoring and found that "while India remains overall the most attractive location, other countries are not far behind."<sup>83</sup> A strong understanding of local regulations and culture makes the Philippines a favorite for the United States, and Central European countries, a

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77. See generally MGI FRANCE, *supra* note 15; MGI GERMANY, *supra* note 49.

78. See MGI FRANCE, *supra* note 15, at 16.

79. See, e.g., *id.* at 8, 16–19.

80. See MGI LABOR MARKET, *supra* note 3, at 30 (providing a study of supply and demand forces on the global labor market to assess the speed and depth of offshoring that will occur).

81. *Id.*

82. *Id.* at 29 n.3 (studying Brazil, Czech Republic, Hungary, Malaysia, Mexico, Philippines, Poland, Russia, Argentina, Bulgaria, Chile, Columbia, Croatia, Estonia, Indonesia, Latvia, Lithuania, Romania, Slovakia, Slovenia, South Africa, Thailand, Turkey, Ukraine, Venezuela, and Vietnam as low-wage countries to which offshoring might be possible).

83. Mattoo & Wunsch-Vincent, *supra* note 35, at 771–72.

favorite for Europe.<sup>84</sup> A large pool of technical talent make Russia and China potential contenders, but they are hindered by weak infrastructures and language barriers.<sup>85</sup>

In the competition to attract more jobs and investment to their countries, developing nations are radically changing their policies, and many critics contend that China will set the floor for these policies.<sup>86</sup> China originally opened its doors in 1977 to foreign trade, but maintained restrictions like trade barriers, investment restrictions, difficult bureaucracies, and a “Wild West legal system” which offered no recourse to ensure that the government remained in control and limited economic penetration.<sup>87</sup> By 2001, however, opportunity costs were becoming too high because China was not more attractive in the offshoring market.<sup>88</sup> As a result, China finally agreed to liberalize by joining the World Trade Organization (“WTO”) which allowed investors to be protected by international law and standard business practices.<sup>89</sup> By agreeing to WTO rules, Beijing must provide a level playing field among all companies and individuals participating in its economy, whether or not they are Chinese or foreigners.<sup>90</sup> For example, the same tariffs, regulations, and international arbitration procedures must be applied.<sup>91</sup> Based on this reform, “Government bureaucrats became more customer friendly, procedures for investments were streamlined, and websites proliferated in different ministries to help foreigners navigate China’s business regulations.”<sup>92</sup>

Given China’s sheer labor market size and new attractive

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84. *Id.*

85. *Id.*

86. THOMAS L. FRIEDMAN, *THE WORLD IS FLAT* 118 (2005) (explaining that the floor is defined as the absolute lowest price for the services and consequentially, the lowest level of employment standards and legal regulations).

87. *Id.* at 115.

88. *See id.* at 114–16.

89. *See id.* at 116.

90. *Id.* at 116.

91. *Id.*

92. *Id.*; but see Ian Bremmer, *Managing Risk in an Unstable World*, HARV. BUS. REV., June 2005, at 54 (explaining that China’s political system is still unstable and an economic slow down could spur a reversal of its current liberalization progress).

policies, it has effectively set the floor for the type and magnitude of incentives that a country will offer multinational companies considering offshoring.<sup>93</sup> Incentives now currently include “tax breaks, education incentives, and subsidies, on top of their cheap labor . . . .”<sup>94</sup> Additionally, China will now also be able to dictate how lax labor laws and workplace standards can become.<sup>95</sup> For many involved in offshoring, this phenomenon has become known as the “China price.”<sup>96</sup> It is this very phenomenon that spurs anti-offshoring policies in most nations.

To remain viable in spite of the Chinese competitive advantage, other countries are quickly focusing on two potential differentiation strategies: specializing in a higher value skill set and building capabilities in a particular industry.<sup>97</sup> India, for example, is already experiencing a lack of competitiveness on wages in comparison to Vietnam and China.<sup>98</sup> As a result, Indian service suppliers are moving to higher value analytical tasks to bolster their offshoring trend and differentiate themselves in the offshoring market.<sup>99</sup> This opportunity is made possible by further “fragment[ing] production processes”<sup>100</sup> that initiated offshoring in the first place. Over time, migration “up the value chain” is expected to continue as offshore suppliers focus on “innovation, consulting, branding and increasingly integrated services.”<sup>101</sup> The result will be “more sophisticated cross-border trade activities like ‘Training/Online Education,’ ‘Product Design and Development Services,’ and ‘Technical Testing,’” and it is only a question of time before service suppliers move into more expert-based service areas like legal, health, and R & D services.<sup>102</sup> Beyond moving up the value chain, a second

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93. See FRIEDMAN, *supra* note 86, at 116–17.

94. See *id.* at 117.

95. See *id.* at 118.

96. *Id.*

97. See Mattoo & Wunsch-Vincent, *supra* note 35, at 771; MGI LABOR MARKET, *supra* note 3, at 46–47.

98. Mattoo & Wunsch-Vincent, *supra* note 35, at 771.

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

emerging differentiation strategy is to focus on a particular industry.<sup>103</sup> Countries following this strategy will tailor their incentive packages to the selected industries and will work to establish a higher quality workforce suited for this smaller type of industry.<sup>104</sup> Additionally, countries may also tailor their infrastructure, tax regime, and intellectual property law to meet the needs of the particular industry.<sup>105</sup> In so doing, a country can become more attractive as a niche player in the offshoring market. This approach has already worked for some nations.<sup>106</sup> For example, Procter and Gamble outsourced to the Philippines in order to take advantage of its large supply of accountants trained in U.S. accounting standards.<sup>107</sup> General Electric (“GE”) is a heavy investor in Hungary because of its cultural and linguistic similarities to Western European countries and favorable privacy laws.<sup>108</sup>

Overall, suppliers of offshoring services stand to win from offshoring, but at what cost? If China is allowed to set the floor too low, all participating nations will struggle to provide reasonable working conditions for their citizens unless they are able to differentiate themselves from direct competitors.<sup>109</sup> As a result, organizations, like the WTO, must work to create treaties to set a realistic minimum standard.<sup>110</sup> Internally, countries will also need to continue to work to build sustainable social policies that will ensure the competitiveness of their workforce over time as well as to provide incentives to companies to invest in their countries.<sup>111</sup> These legislative opportunities and implications will be addressed in detail in Part III of this paper.

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103. See MGI LABOR MARKET, *supra* note 3, at 46–47.

104. *Id.*

105. *Id.*

106. See Mattoo & Wunsch-Vincent, *supra* note 35, at 772.

107. *Id.*

108. *Id.*

109. See FRIEDMAN, *supra* note 86, at 117–18.

110. See Holcombe, *supra* note 8, at 610.

111. See Diana Farrell, Antonio Puvon, & Jaana K. Remes, *Beyond Cheap Labor: Lessons for Developing Economies*, MCKINSEY Q., No. 1, 2005, at 106.

## III. LEGISLATING TO MAXIMIZE THE WIN-WIN

Across the globe, policies addressing offshoring span a broad continuum, from banning, to regulating, to providing incentives.<sup>112</sup> This continuum is the result of an unresolved debate as to whether offshoring is beneficial or detrimental to a nation.<sup>113</sup> Until the debate is resolved with actual facts, tactical legislation and treaties, acting as milestone wins on the part of the debaters, will continue to emerge across the continuum.<sup>114</sup> This section will explore the continuum by examining what legislation has emerged, the rationale for and against the legislation, and its implications on building a win-win dynamic.

A. *Will Protectionistic Legislation Really Help Anyone?*

At one end of the continuum is legislation to prohibit or ban offshoring. To date, this legislation has largely focused on government procurement contracts.<sup>115</sup> However, this legislation could also effectively stifle companies from offshoring work for their other customers if the restrictions are broadly construed.<sup>116</sup> In the United States, for example, “[a]t least 23 states and the U.S. Congress currently have bills pending that affect or relate to offshoring.”<sup>117</sup> In 2003–2004, Kansas, Missouri, and New Jersey successfully passed bills or adopted executive orders to prohibit offshoring certain government work.<sup>118</sup> As an example:

Kansas adopted an offshoring prohibition in an appropriations bill that prohibits the department of

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112. See Mattoo and Wunch-Vincent, *supra* note 35, at 787–95 (noting several different approaches by WTO countries in outsourcing); see also Manley & Hobby, *supra* note 3, at 403–04; (finding a lack of reliable statistics on offshoring even in the United States).

113. See *supra* notes 3–7 and accompanying discussion.

114. See also MGI LABOR MARKET, *supra* note 3, at 21 (explaining that so far the debate has been “fueled by anecdote rather than fact”); Manley & Hobby, *supra* note 3, at 409.

115. Mordecai, *supra* note 3, at 96–101 (categorizing five types of protectionistic legislation as: limitations on awards of government contracts, mandatory offshoring disclosures, identification of call center locations, prohibitions on the transmission of information, restrictions on state assistance available to offshoring businesses).

116. See *id.* at 96–105.

117. See Dauer, *supra* note 13, at 10.

118. *Id.*

social and rehabilitation services, through June 2005, from contracting “for the customer service program relating to the electronic benefit transfer portion of the food stamp vision card program” with any company that performs or subcontracts the work to be performed outside of the United States.<sup>119</sup>

Kansas’ law is fairly narrow in that it only impacts the government contract itself, but other states have proposed legislation which reaches further, in that it impacts how a company operates to serve other customers.<sup>120</sup> For example, “Pennsylvania has proposed legislation . . . that prohibits public contracting with a bidder that has relocated jobs from the United States to a foreign country within the three years prior to submitting its bid.”<sup>121</sup> This legislation would effectively disincentivize a company from offshoring for any reason.

The justification for legislation to ban offshoring is simple, yet potentially misguided. For instance, Washington state’s 2005 House Concurrent Resolution 4405 gives its justification as:

- 1) [J]ob loss and its effect on “communities already suffering from high unemployment and a jobless recovery,”
- 2) [R]isk to “the privacy of medical records, financial data, and other personal information,”
- 3) [L]oss of tax revenues to “provide for the basic education” and public health and safety,
- 4) [T]ransfers of knowledge limiting the ability of Washington State businesses to be innovative, and
- 5) [L]oss of public revenues expended to train the workforce and attract businesses to the state.<sup>122</sup>

Each of these justifications for restricting offshoring could potentially have an impact, but the central issue is whether banning offshoring is the right policy solution. Granted, short-term job loss has a real and tangible impact on a community, but it is hardly a reason to ban offshoring when the jobs could

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119. *Id.*

120. *See id.* at 11.

121. *Id.*

122. *Id.* at 10.

just as easily be moved out of state and produce the same result.<sup>123</sup> Additionally, empirical evidence suggests that net job loss is not a foregone conclusion.<sup>124</sup> The United States, as discussed earlier in this report, gains jobs through offshoring, whereas Germany and France lose jobs.<sup>125</sup> As a result, jumping too quickly to ban offshoring is short sighted; rather, legislation should seek to address the root issues of how to stimulate job growth in an area impacted by offshoring (for example, education programs, tax incentives to recruit businesses).<sup>126</sup> Likewise, each of the other justifications could be addressed more productively through regulation of offshoring.<sup>127</sup> Ultimately, if businesses are not able to compete freely in the open market, they will decline and eventually close, causing complete and irreparable job loss along with costly tax revenue implications.<sup>128</sup> Also, banning offshoring is in direct contradiction to most international treaties.<sup>129</sup> As a result, it is unlikely to be sustained by countries' court systems.<sup>130</sup> Most countries involved in offshoring today belong to the WTO which establishes rules of trade between nations.<sup>131</sup> Specifically, the General Agreement on Trade in Services (GATS) is a treaty organized by the WTO to ensure open trade for services typically provided through offshoring.<sup>132</sup> GATS allows a common platform to:

Commit to grant market access (that is, not to impose any quotas or prohibitions) and national treatment (that is, not to discriminate against foreign providers in

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123. *See id.*

124. *See, e.g.,* MGI FRANCE, *supra* note 15, at 5–6.

125. *Id.*

126. *See infra* Part III.C.

127. *See infra* Part III.B.

128. MGI FRANCE, *supra* note 15, at 13–14; *see also* Mattoo & Wunsch-Vincent, *supra* note 35, at 799 (noting the tax implications on loss of outsourcing revenue).

129. Dauer, *supra* note 13, at 12.

130. *See id.*

131. MGI LABOR MARKET, *supra* note 3, at 12–13; World Trade Organization, [http://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/org6\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm) (last visited Oct. 20, 2006).

132. Sage Colleges, Terms & Definitions, <http://www.sage.edu/academics/schoolofprofessionalstudies/management/programs/definitions.htm> (last visited Oct. 21, 2006).

any way). A full commitment from a country on market access and national treatment is a guarantee against most forms of protection—but not all . . . .<sup>133</sup>

Commitments to GATS by nations vary greatly, but as nations commit, legislation to ban or heavily regulate offshoring could be objectively challenged.<sup>134</sup> Additionally, other international treaties, like the North American Free Trade Agreement (“NAFTA”) and the WTO Agreement on Government Procurement, would likely prevent legislation completely banning offshoring from being upheld.<sup>135</sup>

In addition to treaties, most nations’s governing documents and public policies prevent a complete ban on offshoring from being tenable.<sup>136</sup> In the United States, for example, the “Constitution clearly defines that the authority to regulate trade with foreign nations rests with the federal government.”<sup>137</sup> Thus, state laws banning offshoring may violate the commerce clause.<sup>138</sup> With this complication in mind, the governor of California and the Attorney General of Maryland have already expressed disapproval of legislation banning offshoring in their states.<sup>139</sup>

#### *B. Can Regulation Minimize the Harms Feared in Offshoring?*

Since banning offshoring is not likely to be an appropriate point in the continuum, regulating offshoring may be the right answer to minimize harms and maximize benefits. By breaking down the justifications for banning offshoring, a clear set of areas for regulation begin to emerge: “privacy, labor rights, intellectual property, immigration, environmental protection,

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133. *Id.*

134. *See id.* at 775.

135. *See, e.g.,* Dauer, *supra* note 13, at 12 (discussing the pending state proposals in the United States that conflict with established international treaties).

136. *See id.* (identifying U.S. policies that prevent such a ban).

137. *Id.* (quoting Arnold Schwarzenegger, Veto Message to Members of the California State Assembly (Sept. 29, 2004), *available at* [http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab\\_1801-1850/ab\\_1829\\_vt\\_20040929.html](http://www.leginfo.ca.gov/pub/03-04/bill/asm/ab_1801-1850/ab_1829_vt_20040929.html)).

138. *Id.*

139. *Id.*

taxation, export controls and national security.”<sup>140</sup> To address these areas, rather than “creating an entirely new policy regime, a viable option may be to expand and amend currently existing laws to accommodate the demonstrated effects of offshore outsourcing.”<sup>141</sup> This approach is recommended because it will be easier for existing governmental agencies and administrations to understand and administer.<sup>142</sup> In addition, it will be faster to establish.<sup>143</sup> Speed is particularly essential. As mentioned earlier, offshoring is growing rapidly, and without appropriate regulations, abuses will quickly become rampant and taint future investment decisions to do offshoring.<sup>144</sup> As a result, building appropriate legislation quickly is critical to the overall success of offshoring operationally as well as politically.

When developing the new legislation, striking the right balance between the level of national regulation versus cross-national regulation is important to ensure ongoing competitiveness. As mentioned earlier, the “China price” is a real concern because it may set the bar too low.<sup>145</sup> Regulation could play an important role in setting an appropriate standard.<sup>146</sup> The central issue is how proactively a nation should self-regulate.<sup>147</sup> Individually, nations will find this a problematic situation. On the one hand, if they adopt these regulations, they will detrimentally impact their nation’s ability to compete in the offshoring market.<sup>148</sup> On the other hand, if they do not, they are promulgating and expanding a potentially detrimental situation for their citizens.<sup>149</sup> Therefore, the only solution to properly align

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140. Holcombe, *supra* note 8, at 549.

141. *Id.*

142. *See id.* at 581.

143. *See id.*

144. *See* TRADE UNION ADVISORY COMMITTEE TO THE ORGANIZATION FOR ECONOMIC DEVELOPMENT, TRADE; OFFSHORING OF JOBS AND STRUCTURAL ADJUSTMENT: THE NEED FOR A POLICY RESPONSE 1 (2004), available at <http://www.tuac.org/statemen/communiq/LiaisonCom04.pdf>.

145. FRIEDMAN, *supra* note 86, at 118.

146. *See id.* at 125–26.

147. *See id.* at 204–05.

148. *See* Dauer, *supra* note 13, at 12–13.

149. *See, e.g.*, EAST ASIA ANALYTICAL UNIT, DEP’T OF FOREIGN AFFAIRS AND TRADE, THE NEW ASIANS: VIETNAM, BURMA, CAMBODIA, & LAOS 229–30 (1997) (discussing how

incentives is to pursue global regulation so that no nation is significantly worse off for having higher standards.<sup>150</sup> As discussed earlier, the WTO GATS plays a significant part in managing national legislation so that the bar is not set too high or too low.<sup>151</sup> Beyond the WTO, other organizations are involved in addressing the deeper integration of regulations across borders, such as the Organisation for Economic Co-operation and Development (OECD), addressing the issue of tax treatment, the World Intellectual Property Organization (WIPO), addressing issues related to the protection of intellectual property rights, and the Council of Europe, addressing certain aspects of cyber crime.<sup>152</sup> “The challenge is to ensure that the regulatory cooperation . . . is not exclusionary and leading to regulatory trade diversion but inclusive and encouraging the enhanced participation of developing countries in service trade.”<sup>153</sup>

To fully understand these dynamics, consider the evolution of privacy laws, which are central to any analysis of offshoring. Historically, nations have enacted their own laws to protect citizen’s privacy within their boundaries.<sup>154</sup> These laws, often a mosaic of “spot” domestic legislation that has evolved over time, vary widely between countries in terms of their degree of protection.<sup>155</sup> As a result, work performed outside of a nation’s boundaries may lack the protections expected by its citizens.<sup>156</sup> For example, because current “federal privacy laws do not

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the Cambodian government’s lack of market regulation lowers safety standards for its citizens and indirectly affects domestic companies).

150. Mattoo & Wunsch-Vincent, *supra* note 35, at 797.

151. See GATS—*What is Fact and What is Fiction? A Civil Society Responds to the WTO’s Publication “GATS—Fact and Fiction,”* PUBLIC CITIZEN, May 25, 2001, [http://www.citizen.org/print\\_article.cfm?ID=5567](http://www.citizen.org/print_article.cfm?ID=5567).

152. Mattoo & Wunsch-Vincent, *supra* note 35, at 797.

153. *Id.*

154. See Gramm-Leach Bliley Act, Pub. L. No. 106-02, 113 Stat. 1338, 1436 (1999) (codified as amended at 15 U.S.C. § 6801 (2000)) [hereinafter Gramm-Leach Bliley Act] (stating Congress’ policy that financial institutions respect and protect private customer data); Holcombe, *supra* note 8, at 549.

155. Holcombe, *supra* note 8, at 551; see also Eric G. Barber, *Judicial Discretion, Sentencing Guidelines, and Lessons from Medieval England, 1066–1215*, 27 W. NEW ENG. L. REV. 1, 5 n.22 (2005) (defining spot legislation).

156. See Holcombe, *supra* note 8, at 551.

protect individuals when foreign companies misuse their personal information,' [and w]ith between 150,000 and 200,000 American tax returns being prepared in India, many fear that this sensitive data could be exploited overseas."<sup>157</sup>

To address this issue, the United States acted independently<sup>158</sup> while Europe acted collectively to revise existing laws.<sup>159</sup> The implications of their choice in approach is that Europe has set a standard for future offshoring transactions<sup>160</sup> while the United States has created a unique compliance scenario for which niche offshoring players will be created to serve its market.<sup>161</sup> Specifically, in response to widespread identity theft issues, the U.S Congress passed the Gramm-Leach-Bliley Financial Modernization Act and the Health Insurance Portability and Accountability Act ("HIPAA").<sup>162</sup> These laws significantly consolidate the existing mosaic of state laws and achieve the goal of improving privacy but greatly increase the cost of compliance.<sup>163</sup> For example, the cost of compliance with HIPAA in economic terms is estimated to be "\$3.2 billion for the first year, and \$17.6 billion for the first 10 years."<sup>164</sup> The costs are so high because:

The rigorous data safeguards imposed under HIPAA may warrant self-assessments, employee training, and increased technological capacities to assure compliance. In outlining some of the necessary steps, the National Institute of Standards and Technology published a

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157. *Id.*

158. See John F. Delaney, *Privacy, Data Security, and Outsourcing: The Regulatory Framework*, 844 PLI/PAT 611, 637 (2005) (stating the fundamental differences between U.S. and European approaches).

159. See *id.*

160. Shaw Pittman LLP, *Offshoring and Data Protection: The Cost to E.U. Businesses* (Aug. 2004), <http://www.legaltechnology.com/casestudies/EUdataprotectionandoffshoring.doc>.

161. Holcombe, *supra* note 8, at 557.

162. Gramm-Leach Bliley Act, *supra* note 154, at 1436; Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936, 2026 (1996) (codified as amended in 42 U.S.C. § 1320(d)).

163. See Holcombe, *supra* note 8, at 553-57 (discussing the Gramm-Leach-Bliley Financial Modernization Act and the Health Insurance Portability and Accountability Act).

164. *Id.* at 557.

ninety-six page analysis to detail some ways in which companies can best comply.<sup>165</sup>

Beyond the costs, the United States' independent approach to privacy has generated a niche market for offshoring companies who are capable of providing services within these standards.<sup>166</sup> The very need to use these niche players is evidence itself that the U.S. standards are too unique, causing the cost of doing business to rise for U.S. companies out of competitiveness with other nations.

Alternatively, rather than acting individually as nations, Europe has banded together to set a privacy standard which all must follow.<sup>167</sup> "The European Union Data Protection Act bars 'transfer of personal information from European Union countries to another country *unless* that country's laws have been certified by the EU as providing "adequate" protection of the personal data."<sup>168</sup> Since its enactment, this directive has become an example for many nations to use when restructuring their own laws.<sup>169</sup> "So far, a number of non-EU countries—including Argentina, Australia, Canada, Hong Kong, Hungary, New Zealand, and Switzerland—have passed data protection laws similar to those of the EU."<sup>170</sup> In order to remain competitive, more nations will probably follow the European privacy approach, especially as global acceptance grows.<sup>171</sup> Indian business leaders, for example, believe that the successful passage of an Indian data protection law will reduce fears among multinational corporations of data piracy and improve the marketability of Indian firms.<sup>172</sup>

As this example shows, offshoring can drive a win-win situation that collectively raises the bar for everyone when nations work together to set a regulatory standard. The benefits

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165. *Id.*

166. *See, e.g., id.* (noting the niche market that grew up around HIPPA compliance).

167. Delaney, *supra* note 158, at 637.

168. Holcombe, *supra* note 8, at 570–71.

169. *Id.* at 574.

170. *Id.*

171. *Id.*

172. *Id.*

of following the global standard far outweigh the costs of setting unique standards, opting out of the market, as banning offshoring would do, or failing to provide services at that standard as the “China price” theory suggests.<sup>173</sup> Thus, a win-win situation can be driven by the pressures of offshoring much to the dismay of those wishing to ban offshoring.

*C. What Enabling Legislation Could Help to Maximize the Value for All?*

Pro-offshoring legislation often takes two forms: free trade treaties to ensure openness to offshoring and legislation to stabilize the society.<sup>174</sup> As discussed earlier, the WTO’s GATS is a comprehensive effort to ensure free trade in the service sector.<sup>175</sup> Unfortunately, to date, ongoing negotiations relating to GATS of the Doha Development Agenda have produced disappointing results.<sup>176</sup> The negotiations seem to have lost momentum because countries are following a request offer process that prevents a true openness to trade.<sup>177</sup> However, negotiations are expected to continue, and the GATS agreement is expected to be the best line of defense against protectionist legislation at the national level.<sup>178</sup> Beyond this type of comprehensive legislation, many nations are actively pursuing bilateral, regional, and multilateral agreements which, although

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173. See *Putting Your Own House in Order Before Offshoring*, [http://www.borland.com/resources/en/pdf/white\\_papers/offshoring\\_exec\\_white\\_paper.pdf](http://www.borland.com/resources/en/pdf/white_papers/offshoring_exec_white_paper.pdf) (last visited Oct. 22, 2006) (“Given the bottom-line benefits, the decision to offshore seems obvious for most CEOs.”); Mordecai, *supra* note 3, at 92 (discussing that while short-term hardships will occur with offshoring, the rewards will eventually offset these problems).

174. See generally Holcombe, *supra* note 8 (discussing various treaties and legislation).

175. See *supra* notes 127–28 and accompanying text; Mattoo & Wunsch-Vincent, *supra* note 35, at 774.

176. See Mattoo & Wunsch-Vincent, *supra* note 35, at 766.

177. See generally WTO Seminar on the GATS: Technical Aspects of Requests and Offers (Feb. 20, 2002), [http://www.wto.int/english/tratop\\_e/serv\\_e/requests\\_offers\\_approach\\_e.doc](http://www.wto.int/english/tratop_e/serv_e/requests_offers_approach_e.doc) (last visited Oct. 21, 2006) (describing the request and offer process as an exchange, by Ministers, of political commitments relating to trade restrictions and liberalizations in the services sector).

178. Mattoo & Wunsch-Vincent, *supra* note 35, at 765–66.

not ideal, will serve the same purpose.<sup>179</sup> For example, “in 2004, the United States entered four free trade agreements (FTAs): the U.S.-Australia Free Trade Agreement, the U.S.-Bahrain Free Trade Agreement, U.S.-Morocco Free Trade Agreement, and the Central American Free Trade Agreement (CAFTA).”<sup>180</sup> Through these agreements and treaties, the flow of offshoring can be protected and stimulated by maintaining open borders and free markets.

The second form of positive offshoring legislation is directed domestically to provide incentives for the local economy to adjust proactively to the globalization movement.<sup>181</sup> For example, India, under Prime Minister Atal Behari Vajpayee’s leadership, focused on liberating its economy by steering domestic legislation and policies to support offshoring.<sup>182</sup> As a reward, India received billions in direct foreign investment and saw significant growth in its economy.<sup>183</sup>

#### *D. Legislation Recommendations*

Going forward, national leaders should focus their efforts on enabling offshoring in the offshoring legislation continuum. Specifically, leaders should seek to develop global standards for core issues surrounding offshoring, including privacy and labor rights. These standards should then be promulgated in international treaties, national legislation, and corporate policies to enable consistent regulation that will support a win-win dynamic among nations. Additionally, broad agreements supporting free trade are essential to ensure the free flow of services and skills across nations. By focusing on the enabling side of the continuum, the value from offshoring can be maximized for all.

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179. Holcombe, *supra* note 8, at 600–01.

180. *Id.* at 601.

181. Farrell, et al., *supra* note 111.

182. *India: Taking a Step Forward*, OFFSHORE OUTSOURCING WORLD, May 22, 2004, <http://www.enterblog.com/200405221534.html>.

183. Mordecai, *supra* note 3, at 105.

## IV. BUILDING A BODY OF SUCCESSFUL OFFSHORING DEALS

Beyond developing a positive legislative environment in both developed and developing nations, a second strategic element essential to maximizing the value of offshoring is creating a body of successful offshoring deals to encourage further investment by corporations.<sup>184</sup>

A. *Why Are Offshoring Deals Complex and Likely to Fail?*

Offshoring transactions are complex, requiring consideration of:

[G]eopolitical risks, cultural and language differences, foreign currency exchange fluctuations, local law issues, potential conflicts of law, jurisdiction for enforcement, resolution of disputes, intellectual property ownership and technology transfer risks, infrastructure issues, security, taxes, management controls, service level agreements, time differences, warranties, indemnities, termination, liability limitations, termination assistance and many other issues.<sup>185</sup>

Lawyers play a role during all phases of the deal: preparation, negotiation, implementation, and ongoing management.<sup>186</sup> The most important role, however, is in drafting

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184. MGI LABOR MARKET, *supra* note 3, at 14.

185. J. T. Westermeier, *Mock Negotiation of International Outsourcing Agreements*, 822 PLI/PAT 377, 383 (2005); *see also* MICHAEL S. MENSIK & BRIAN HENGESBAUGH, BAKER & MCKENZIE, *OUTSOURCING TO INDIA: KEY LEGAL & TAX CONSIDERATIONS FOR U.S. FINANCIAL INSTITUTIONS* 1 (2004), *available at* [http://www.bakernet.com/NR/rdonlyres/E5AB9C9D-6C88-4A1C-8A7F-8748B21B9EB5/0/Really\\_Done\\_White.pdf](http://www.bakernet.com/NR/rdonlyres/E5AB9C9D-6C88-4A1C-8A7F-8748B21B9EB5/0/Really_Done_White.pdf) (listing potential legal issues involved in offshoring).

186. *See* MENSIK & HENGESBAUGH, *supra* note 185, at 2. The author explains the roles of the lawyer at each phase of an offshoring deal. *Id.* During preparation, the lawyer is responsible for assessing the legal and tax issues, conducting due diligence, and preparing the bid and proposed service agreement. *Id.* During negotiations, the lawyer typically conducts competitive negotiations in parallel with more than one provider. *Id.* In implementation, the lawyer helps to ensure the orderly transfer of resources (e.g., employees, technology, equipment, real estate, facilities, and intellectual property licenses). *Id.* During ongoing management, the lawyer typically remains on-call to assist in interpreting the contract, resolving disputes, and amending the agreement. *Id.*; *see also* Rachelle C. Sampson, *The Role of Lawyers in Strategic Alliances*, 53 CASE W. RES. L. REV. 909, 925–27 (explaining the importance of lawyers in strategic alliances by

effective contracts and master service agreements because they are the cornerstone of successful offshoring deals.<sup>187</sup> Yet, attorneys struggle to draft these contracts because they require the creation of a viable tension between a watertight arrangement that protects clients, and a flexible agreement needed to support the evolution of the services and relationship over time.<sup>188</sup>

The failure and rampant renegotiation of intracountry outsourcing deals in the United States, a less complex transaction than offshoring, highlight the immaturity of current drafting capabilities.<sup>189</sup> A Dun and Bradstreet study found that “25 percent of all firms’ functions report an outsourcing relationship failure within the past two years.”<sup>190</sup> Another study by Dataquest reported that “more than half (53 percent) of all outsourcing customers surveyed said that they had renegotiated an outsourcing contract, and in nearly one-quarter of these renegotiations the provider lost the account.”<sup>191</sup> Broad

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analogizing to the role of structure in strategic alliances); Westermeier, *supra* note 185, at 384 (describing the key to negotiating).

187. See generally Chris Holder, *United Kingdom: A Guide to Achieving a Successful Outsourcing Agreement*, MONDAQ BUS. BRIEFING, July 21, 2004, <http://www.mondaq.com/article.asp?articleid=27435> (providing a checklist of features and guidelines on how to approach outsourcing).

188. Pink, *supra* note 27, at 366; see also Paul J. N. Roy, *Legal Outsourcing Trends — A Look Ahead*, OUTSOURCING JOURNAL, <http://www.outsourcing-journal.com/jan2003-legal.html> (discussing the difficulty in crafting an outsourcing agreement); Westermeier, *supra* note 185, at 383–84 (arguing that flexibility in contracting is required).

189. See IAOP, *supra* note 25 (discussing the “disconnect between a customer’s expectations and the perceived results” as the reason for contract failures); Pink, *supra* note 27, at 377–79 (providing reasons for outsourcing failures and discussing the challenge of drafting an outsourcing agreement). See generally ADAM D. VERESHACK, *A PRACTICAL GUIDE TO OUTSOURCING AGREEMENTS* (2005) (describing outsourcing agreements that often have issues with transition of employees, changing methodologies, improvements and gain sharing, benchmarking, performance and service levels, and offshoring).

190. IAOP, *supra* note 25 (analyzing telephone interviews with 2,200 companies with revenues of \$10 million or more in sales, 1,000 interviews with smaller firms, and data from its database of more than 57 million companies worldwide).

191. *Id.*; see also Davenport, *supra* note 8, at 102 (expressing the opinion that the lack of process standardization explains why companies are dissatisfied with their outsourcing relationships).

renegotiations are an unfortunate outcome from overly tight agreements that leave business leaders little protections to adjust their contracts based on changing business needs and new economic standards.<sup>192</sup> This high renegotiation rate for outsourcing is a reasonable forecast of the levels that will occur when offshoring becomes widely adopted.<sup>193</sup>

*B. How Can Contracts Have a Viable Tension Between Protection and Flexibility?*

Baker & McKenzie, in studying this issue, has already reviewed multiple offshoring contracts and found that:

Several areas that frequently prove deficient include: (i) “in-scope service” definition; (ii) sub-contracting rights and obligations; (iii) change control procedures; (iv) “insourcing” rights, (v) governance structure; (vi) data protection provisions; (vii) legal compliance obligations; (viii) ongoing monitoring and audit rights; (ix) termination assistance and transition obligations; and (x) assignment, protection and perfection of intellectual property rights.<sup>194</sup>

To address these deficiencies, the offshoring attorney should seek to establish a viable tension by “develop[ing] a structure for governing the relationship that is clear and well-defined, but flexible enough to accommodate changes in the relationship.”<sup>195</sup> To demonstrate drafting with a viable tension in mind, several contractual areas will be explored in more detail: pricing, compliance, and dispute resolution.

A viable tension in pricing is generated by the desire of the customer to lock in savings over a period of time and yet allow for the scope of the services purchased to be malleable based on

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192. Roy, *supra* note 188 (providing an explanation of why the renegotiation trend is occurring).

193. See *id.*; MENSİK & HENGESBAUGH, *supra* note 185, at 3–8 (providing a complete hypothetical of an offshoring deal to India that may need to undergo renegotiations due to issues in income tax; employment, immigration, and employment related tax; regulatory compliance; intellectual property; and dispute resolution).

194. MENSİK & HENGESBAUGH, *supra* note 185, at 8.

195. Pink, *supra* note 27, at 366.

changing business needs.<sup>196</sup> For example, a customer may want to ensure a ten percent year-on-year cost improvement in desktop support services, but leave open the possibility that all desktops may be converted to laptops over the course of the contract without impacting the pricing structure. Obviously, building these protections and flexibilities into a static contract, which is agreeable to both parties, is the challenge. In pricing, drafting terms are evolving to generate the necessary viable tension. Traditionally, fixed bid contracts would provide the watertight security customers desired.<sup>197</sup> However, vague service definitions and changing business requirements created additional “out of scope charges” to be assessed, eroding the savings from the deal, and when business volume requirements declined, customers were often still required to pay the fixed fee for the baseline volumes regardless of changing business needs.<sup>198</sup> “Consequently, customers are forced to re-open negotiations to take advantage of additional cost savings opportunities and adapt to new economic standards. [Also,] [t]he lure of new business or the threat of a declining scope may serve as the motivation for renegotiation.”<sup>199</sup> Breaking the pattern requires building in a viable tension. New approaches have been developed that allow the service provider and the customer to negotiate the risks of evolving services.<sup>200</sup> One emerging approach is for the vendor to accept responsibility for evolving the service at no additional charge to the client.<sup>201</sup> Services are simply defined in the contract to include the normal evolution

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196. *See id.* at 377 (describing the trend of flexibility).

197. *See id.* at 366 (stating that some attorneys are trained to create watertight contracts).

198. *See id.* at 373 (describing service level issues).

199. Roy, *supra* note 188.

200. *See* Westermeier, *supra* note 185, at 384–85 (explaining how negotiating flexibility and change management into outsourcing agreements is becoming increasingly necessary to mitigate the risk of evolving services).

201. Pink, *supra* note 27, at 373 (discussing a new pricing term that accommodates changes in technology). *Cf.* Felix Barber and Rainer Strack, *The Surprising Economics of a “People Business,”* Harv. Bus. Rev., June 2005, at 84 (providing a new approach for measuring performance in a service based business). The rationale for the offshorer to absorb the cost of improvement is that the cost of improvement is offset by the savings generated by a more efficient service. *See* Pink, *supra* note 27, at 373.

expected in the industry through technology developments.<sup>202</sup> Thus, general enhancements to the outsourcer's infrastructure are provided to the customer as part of the deal with no additional charge regardless of how much savings it provides to the client.<sup>203</sup> Another approach requires the outsourcer and the customer to enter into a risk-reward agreement, where the outsourcer and the customer agree to a set of enhancements that will be financed by the outsourcer or jointly by both parties.<sup>204</sup> Once implemented successfully, the parties then share in the savings generated by the enhancement, which typically takes the form of the customer providing a portion of the savings to the outsourcer. If the enhancement is not successful, both parties lose to the extent of their financing of the enhancement. In this way, "the outsourcer is not merely performing a function, but integrally involved in the future prospects and development of the customer's business."<sup>205</sup> By anticipating the changing business needs, the drafting shifts from the traditional watertight agreement to one that accommodates the evolution of the services.

Regulatory compliance is another area where there is a strong desire for watertight precision,<sup>206</sup> and yet there is a need to provide for evolving compliance requirements. As a result, "a well-drafted outsourcing agreement must also contemplate a governance structure that enables the parties to accommodate the changing regulatory landscape and address related cost issues."<sup>207</sup> Generally, "these regulatory compliance duties [Sarbanes-Oxley, HIPAA, E.U. Data Protection Directive, Gramm-Leach-Bliley Act] are non-delegable, which means that the customer bears the risk of liability and adverse publicity if the service provider fails to comply with applicable regulatory

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202. Pink, *supra* note 27, at 373.

203. *Id.*

204. Pink, *supra* note 27, at 369.

205. *Id.*

206. See MENSİK & HENGESBAUGH, *supra* note 185, at 8 (describing how an ideal outsourcing agreement will define each party's regulatory compliance roles and responsibilities with precision).

207. *Id.*

requirements.”<sup>208</sup> As a result, a customer must understand the degree of the requirements and draft its offshoring agreements to ensure compliance.<sup>209</sup> At a minimum, an explicit definition of the parties’ respective roles and responsibilities is required.<sup>210</sup> This should create a collaborative governance structure that will support the process changes required when laws are reformed.<sup>211</sup> When necessary, customers may even apply “more extensive measures—requiring the provider to establish a dedicated ‘special purpose’ company to discharge the work ([for example], the ‘build, operate & transfer’ model).”<sup>212</sup> Another solution is for a company to create their own “captive” service organization.<sup>213</sup>

Drafting for termination provides another area where a viable tension must be accommodated. Traditionally, two types of termination were provided for: “for cause” and “for convenience.”<sup>214</sup> However, recent experiences suggest other situations should be drafted for, including:

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208. *Id.* at 3. See generally Andrew L. Sandler, Anand S. Raman & Valerie L. Hletko, *Outsourcing by Financial Institutions: A Survey Of Regulatory Guidance*, 20 REV. BANKING & FIN. SERVICES 107 (2004), available at <http://skaddenpractices.skadden.com/consumerfinancialservices/index/php?sectionID=32&inline=1> (follow “Outsourcing” section; then follow hyperlink) (highlighting actions required to manage outsourcing risks, including assessing, performing a due diligence of service providers, requiring protective contract terms, and performing ongoing oversight and monitoring); Manley & Hobby, *supra* note 3, at 418–19; (providing examples of nondelegable compliance responsibilities); MICHAEL S. MENSİK & ROBERT GAREIS, BAKER & MCKENZIE, THE SARBANES-OXLEY/OUTSOURCING INTERSECTION: AN INTRODUCTION (2004), <http://www.bakernet.com/NR/rdonlyres/53BC9F5D-47A1-4E85-88C3-27E152D85509/0/CAOutsourcing0904.pdf> (describing the need for public companies to ensure compliance with Sarbanes-Oxley whether or not the activity in question is related to outsourcing).

209. MENSİK & HENGESBAUGH, *supra* note 185, at 3.

210. *Id.*

211. *Id.*

212. *Id.*

213. *Id.* at 8.

214. Brad L. Peterson, *Seven Key Questions for Drafting Effective Exit Provisions*, OUTSOURCING CENTER, Aug. 2002, <http://www.outsourcing-best-practices.com/seven.html>. “For cause” termination occurs when the contract between the parties is breached; “For convenience” termination occurs when a party requests to terminate the contract for a business reason and typically pays a prenegotiated fee to the other party for the convenience of exiting the contract early. *Id.* Pink, *supra* note 27, at 387 (providing examples of traditional terms included within a termination clause).

- “[Service provider goes] out of business (Arthur Andersen),
- Failing to meet financial covenants (WorldCom),
- Bankrupt (Enron and too many dot-coms),
- Incapacitated by a force majeure event (think Wipro or Tata if India goes to war with Pakistan), or
- Unable to keep pace with its own or the customer’s market.”<sup>215</sup>

In these situations, the customer will want to exit the contract without paying a convenience fee.<sup>216</sup> However, unless the contract anticipates these situations or is drafted for this viable tension, the client is not well served.<sup>217</sup>

### *C. Contract Drafting Recommendations*

For offshoring to gain momentum and maximize its potential, a body of successful deals must be generated to serve as a role model for hesitant investors.<sup>218</sup> Drafting contracts with the appropriate viable tension between watertight protections and flexibility to accommodate changing business needs is essential to reduce the backlash and negative publicity of deal failures and rampant renegotiations that have been observed in outsourcing deals,<sup>219</sup> a precursor to offshoring. New approaches

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215. Peterson, *supra* note 214 (providing examples of other exit scenarios which should be addressed in the contract); *see also* Spiotto & Spiotto, *supra* note 25, at 48–49 (illustrating how the risk of the service provider experiencing financial difficulties will have to be addressed in any business outsourcing arrangement); Bremmer, *supra* note 92, at 53 (explaining the anatomy of India’s political risks).

216. Peterson, *supra* note 214.

217. *Id.* *See generally* Alasdair Taylor, *United Kingdom: Excluding Consequential or Indirect Losses in Software and Outsourcing Contracts Governed by English Law*, MONDAQ, June 11, 2004, <http://www.mondaq.com/article.asp?articleid=26613> (describing the importance in explicitly defining potential losses in an outsourcing agreement as opposed to letting those losses be addressed by common law “consequential” or “indirect” losses).

218. *See* MGI LABOR MARKET, *supra* note 3, at 14 (citing “successes of early movers and supporting measures taken by government” as factors in influencing corporate confidence in offshoring).

219. *See* Landers, *supra* note 42, at D4 (describing how companies have either been reluctant to continue outsourcing operations because of a lack of financial success on past deals or have had to address negative publicity associated with the outsourcing

are emerging and examples have been provided for pricing, compliance, and termination terms.<sup>220</sup> Attorneys negotiating these contracts should proactively work with clients to acknowledge the need for drafting with a viable tension in mind to ensure new approaches are actively adopted.<sup>221</sup>

## V. CONCLUSION

### A. *Who Will Win a Disproportionate Share of the Value from Offshoring?*

The passionate debate as to whether offshoring will be a positive or negative influence on the world economy continues to rage because facts are still being gathered and the stakes, in the form of prizes and penalties, are high.<sup>222</sup> Early adopters at the company and national levels have achieved impressive results. Specifically, by 2000, India had used direct foreign investment for offshoring and new pro-offshoring legislation to propel itself to “twelfth among nations in terms of gross national income.”<sup>223</sup> Additionally, by 2001, India was experiencing a trade surplus with the United States of 5.7 billion dollars.<sup>224</sup> Similarly, the United States is gaining \$1.14 to \$1.17 for every dollar it spends in offshoring.<sup>225</sup> With these results, the prize of offshoring is considerable and worth pursuing, but the answer to the question of which countries will win a disproportionate share of the value generated by offshoring remains uncertain. Early front-runners like India, China, and the United States are faltering in their

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arrangement); see also Alan McCord, *Are You Ready to Discuss IT Outsourcing on Your Campus?*, *EDUCAUSE Q.*, No. 1, 2005, at 14 (discussing why outsourcing is limited on campuses).

220. See *supra* Part IV.B.

221. See Holder, *supra* note 187.

222. See MGI LABOR MARKET, *supra* note 3, at 21 (explaining that the debate has so far been “fueled by anecdote rather than fact,” and that every potential production and service job could be outsourced).

223. Mordecai, *supra* note 3, at 94.

224. See *id.* (detailing that the United States imported 9.076 billion dollars worth of goods and services from India in 2001, and only exported 3.425 billion dollars worth of goods and services).

225. MGI FRANCE, *supra* note 15, at 6.

ability to prevent protectionism,<sup>226</sup> leaving the question ultimately unanswered. For example, with the recent elections of:

Sonia Gandhi's Congress Party and its far-left-leaning allies . . . over Prime Minister Atal Behari Vajpayee's incumbent government[,] . . . [t]he general feeling in India is that the parties that are coming into power would drastically slow, if not reverse, the country's liberalization process that began in 1991 and has attracted billions in foreign investment.<sup>227</sup>

Similarly, risk analysts find that China is a political matchbook ready to ignite at a moments notice if the economy begins to decline, causing its liberalization to quickly come to an end.<sup>228</sup> Thus, the door remains open for other developing nations to take market share as suppliers for offshoring. Likewise for developed nations, the protectionistic sentiment in the United States continues to run high as evidenced by the fact that it was a hotly contested topic in the last presidential election and the proliferation of bills attempting to ban offshoring.<sup>229</sup> As a result, who will emerge as a dominate winner from this globalization trend remains to be seen.

Although the prize remains open for the taking, countries cannot afford to sit idly and wait for the early adopters to confirm the value either because the penalties of not participating in the offshoring movement are potentially severe. For example, if a scenario like the "China price" emerges, where the bar for workplace standards and rights protections is set too low, then all nations will experience a decline in their societies as their corporations work to match the "china price."<sup>230</sup> If the companies do not, they will simply go out of business which will

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226. See Mordecai, *supra* note 3, at 104–05 (detailing how recent Indian political development could impact economic development); Bremmer, *supra* note 92, at 53–54 (explaining Indian and Chinese political risks); Dauer, *supra* note 13, at 10–11 (illustrating recent U.S. state legislation regulating offshoring agreements).

227. Mordecai, *supra* note 3, at 104–05; see also Bremmer, *supra* note 92, at 53 (explaining the anatomy of India's political risks).

228. Bremmer, *supra* note 92, at 54.

229. Mordecai, *supra* note 3, at 86, 94–95; see also Dauer, *supra* note 13, at 10–11.

230. FRIEDMAN, *supra* note 86, at 118.

truly cause the feared irreparable job loss and ultimately create a tail spin for a nation's economy.<sup>231</sup> As a result, nations should, at a minimum, work collectively on a global scale with organizations like the WTO, OECD, WIPO, and the Council for Europe to secure free trade and appropriate conditions and protections.<sup>232</sup> Additionally, nations will have to restructure their own labor and product market regulations, such as minimum wage laws, in order to build the flexibility necessary for their economies to adapt to globalization.<sup>233</sup> Sweden provides an excellent example of the consequences for not reforming to meet the demands of globalization.<sup>234</sup> "In 1990, that country boasted the 7th-highest standard of living in Europe; in 2002, it ranked 14th. An inflexible labor market reinforced by restrictive regulations constrained growth in the service sector . . . ."<sup>235</sup> Sweden's experience should serve as a warning to policymakers in other nations with similarly inflexible labor laws, like Germany and France, that inaction is not an option.<sup>236</sup>

Given the significant prizes and penalties offered by offshoring and the lack of clear winners, nations and companies should act rather than merely fuel the debate. A win-win dynamic can be created that would maximize value for all. It will require a body of legislation that opens doors and regulates to ensure improving standards rather than declining ones. In addition, a portfolio of successful, profitable offshoring deals is needed to further spur investments.

### *B. Final Recommendations*

To build a win-win dynamic using legislation, all three parts of the legislative continuum need to be addressed. First, legislation that restricts or completely bans offshoring must be attacked on the grounds that it violates existing free trade

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231. See sources cited *supra* note 3.

232. See Mattoo & Wunsch-Vincent, *supra* note 35, at 797 (discussing organizations that are building global regulations that will support offshoring).

233. See MGI GERMANY, *supra* note 49, at 11–14; MGI FRANCE, *supra* note 15, at 17–19 (providing specific recommendations for labor policy changes).

234. MGI GERMANY, *supra* note 49, at 13–14.

235. *Id.* at 13.

236. MGI GERMANY, *supra* note 49, at 13; see MGI FRANCE, *supra* note 15, at 6.

agreements, violates the governing documents of a country, and places a country's businesses at a competitive disadvantage in the global economy.<sup>237</sup> Additionally, job loss is not a foregone conclusion if appropriate labor reform and repatriation of profits from offshoring occurs.<sup>238</sup>

Second, regulatory-type legislation that protects core rights, like privacy, humane working conditions, and quality standards expected by consumers, should be formed from existing laws rather than from scratch to ensure speed, provide continuity, and minimize the harms offshoring may create.<sup>239</sup> When shaping the legislation, establishing a global community standard is essential to provide a level playing field that is truly win-win and to prevent defection that could generate a "China price" scenario.<sup>240</sup>

Finally, proponents of offshoring should seek to expand national commitments to free trade by supporting the WTO GATS process and enhancing bilateral and multilateral free trade agreements. Only by opening the doors broadly can a nation truly expand its potential for economic growth, whether that be from directly importing jobs or from expanding exports to a stronger, wealthier body of developing nations.<sup>241</sup> Additionally, policymakers should seek to establish incentives for local economies to adjust proactively to the globalization movement, like education programs to aid re-employment in developed nations and spur employment in developing nations.<sup>242</sup>

Even if the ideal legislative environment is created, the economic value of offshoring will not be maximized unless a body of successful offshoring deals is developed to prove the

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237. *See supra* Part III.A.

238. *See supra* Part III.A.

239. *See* Holcombe, *supra* note 8, at 549–50 (explaining how existing laws can be formed to meet the demands of globalization).

240. *See supra* Part III.B.

241. *See supra* Part III.D.

242. *See, e.g.,* Mordecai, *supra* note 3, at 105 (describing the need for the United States to establish educational programs and incentives to allow their workforce to compete in the global labor market).

concept and entice hesitant investors and corporations.<sup>243</sup> At the heart of these successful deals is a contract drafted with a viable tension between protecting the client and providing flexibility to manage the uncertainty around how the client's business will evolve over time.<sup>244</sup> Examples of drafting with a viable tension provide for critical terms in an offshoring deal, including pricing, compliance, and termination. At the core of drafting with a viable tension is an expectation that there is a win-win dynamic that can be established between companies and the countries that host them; otherwise, accepting the risk that flexibility entails would be unacceptable.<sup>245</sup> As a result, the private contracts between companies should mirror the win-win dynamic expected between nations through legislation and treaties.

Offshoring produces economic value for both developed and developing nations if their economies are sufficiently open to seize the opportunity and companies are willing to invest. Proactively legislating for free trade, appropriate standards, and the protection of rights, along with developing a body of successful offshoring deals, will ensure this value continues to grow and benefit all.

*Colleen Walsh Schultz\**

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243. See MGI LABOR MARKET, *supra* note 3, at 14.

244. See *supra* Part IV.B.

245. See *supra* Part IV.B.

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