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A COSTLY DEBATE

With offshore outsourcing, states are squeezed between the prospect of saving money and losing jobs

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When eFunds Corp. decided to move a call center from Green Bay, Wis., to Mumbai, India, a year and a half ago, it might as well have set a match to a stream of gasoline.

The Scottsdale, Ariz., company, a leader in providing services for the electronic payment of state-administered benefits such as food stamps, hadn't informed the state governments it worked for that citizens' calls would be answered in India. When constituents asked why their calls always were being answered by people with Indian accents, state officials and legislators learned that they were using taxpayers' money for offshore services at a time when unemployment was escalating.

New Jersey officials renegotiated the state's contract, bringing a call center to Camden at an increased cost of $73,800 a month. Missouri, too, brought a call center back to the States-it will first move to Wisconsin and eventually to Kansas City-paying an additional $1.2 million annually. Other states followed suit with similar measures involving eFunds and other outsourcers. "We shouldn't be taking taxpayer money out of the country," New Jersey state Sen. Shirley Turner said in a public statement at the time.

EFunds didn't do anything wrong, company officials say, because state contracts didn't specify where work was to be done. The company, which says only a small part of the $48 million in contracts it has with state governments goes offshore**,** now makes it a policy to disclose worker locations in contracts and locate work based on what states request. "There's a visceral reaction to [offshore] outsourcing," says Cheryl Campbell, VP of government solutions for eFunds. "Five years ago, it wasn't an issue."

What has changed is that U.S. jobs-including high-skilled IT jobs-are going overseas to cheaper labor pools at a time when the country is worried about unemployment. IT unemployment, which was less than 3% four years ago, has stabilized at between 5.5% and 6% in the past three years; programmers, analysts, and support specialists have been the hardest hit (see "Tech-Job Upheaval," Aug. 2, p. 20; informationweek.com/1000/jobs.htm).

Although the number of IT jobs going offshore is thought to be relatively small, there's a feeling that this is just the beginning of a trend that doesn't bode well for IT professionals. And, while the issue of companies sending jobs offshore is controversial in itself, when taxpayers dollars are at stake, the rhetoric explodes to the point where many state IT execs refuse even to discuss the issue.

"Tax dollars shouldn't subsidize foreign job creation," says Marcus Courtney, president of WashTech, a labor group for high-tech workers that's affiliated with the Communications

Workers of America. "We have no problem with foreign companies setting up shop here and employing local workers, but why should we send our tax dollars overseas?"

One reason is the potential for budget-constrained state governments to save money using low-priced overseas services. Little work has been done to estimate potential savings from offshoring public-sector work, but a recent survey of the 100 largest New York companies found that they pegged savings at 44% of salary costs and about 20% when other costs such as remote management and infrastructure were figured in. Outsourcers also are able to more quickly and easily implement IT infrastructures for mandated programs that states must put in place on short deadlines.

No one tracks how much work state governments send overseas. A study by research firm Input predicts that outsourcing of state and local government IT projects could grow from $10 billion in 2003 to $23 billion in 2008; however, it's not clear how much would go offshore. In a recent study commissioned by WashTech, researchers matched 300 firms that specialize in offshore outsourcing against lists of vendors working for states; 18 companies accounted for about $75 million worth of taxpayer projects.

"How much is really going offshore?" asks Phil Mattera, whose group, Good Jobs First, a nonprofit research organization that focuses on economic development, conducted the study. "We estimate that state government IT projects are [worth] $40 billion to $50 billion, and if only 2% go offshore-which is a pretty conservative estimate-that's about $1 billion." Offshoring is going on to some degree in every state, he says, with California and Connecticut having the most offshore-out- sourcing companies on their approved-vendors lists.

Even so, nobody knows whether states save money in the long run by outsourcing overseas. Besides communications and other infrastructure costs, state governments must figure in unemployment benefits paid to people who lose their jobs, housing assistance, welfare benefits, and lost tax revenue. "Too many states see outsourcing as an immediate panacea to their budget woes and don't do their due diligence," says Peter Quinn, CIO of Massachusetts. "It should be a business decision. You have to weigh what's best for the taxpayers."

The majority of state outsourcing is to support electronic benefit services mandated by the 1996 Welfare Reform Act. Under the law, states were to have replaced traditional food stamps with debit-type cards two years ago unless they got an extension. These cards can be used for other programs such as temporary assistance to families in need.

The problem with offshore outsourcing, according to Good Jobs First's Mattera and many state officials, is that until states recently demanded it, companies didn't always say where the work was being done. In addition, some companies subcontracted work to companies that sent it offshore and didn't inform state officials. "How do we identify where contract work is being done?" asks Maine CIO Dick Thompson. That information is now required by statute for work contracted out by the state. Maine currently sends some IT work to Canada. "With all the controversy, I'm expecting the next Legislature will have many questions for me," Thompson says.

Other state officials say they're blindsided when companies change hands and new owners don't inform them that the work will shift to overseas locations. For example, Citibank Electronic Financial Services had more than 30 states as clients when it was bought last year by J.P. Morgan Chase & Co., which moved most of the call centers and back-office processing to an Indian subcontractor.

"You have to manage outsourcing just as vigorously as any other contract," Massachusetts CIO Quinn says. "Shame on the people who did a deal and didn't know that it was outsourced." Massachusetts has enacted legislation that bars the use of offshore contractors.

The issue has become so volatile that almost every state has pending legislation aimed at restricting offshore outsourcing (see list, left). Arizona's governor has issued an executive order that prohibits new state contracts that would send work overseas. In May, Tennessee became the first state to pass legislation that gives preference to contractors that use in-state workers. Alabama and Indiana followed with similar laws. The governors of Michigan and Minnesota have signed executive orders giving preference to contractors that use U.S. workers.

"It's all over the map," says Jack Gallt, issues coordinator at the National Association of State CIOs. "Our group couldn't take a national position on offshore outsourcing because there was no consensus. It's a state-by-state issue."

The nuances of the laws can be confusing. "Our executive order says that decisions should be made on best value," notes Kent Allin, Minnesota's procurement director. "And best value includes where the work is being done." Only a handful of contracts are outsourced offshore, he says, and these include food-stamp programs. Contractors are required to state where the work is being done. "They can't change it later on," he says.

Muddying the issue further, some states, including Minnesota, are signatories to the World Trade Organization, so they can't discriminate on larger-dollar-value contracts. An outright ban on offshore contracts would be a violation of the agreement. "For contracts below $477,000, we have more discretion," Allin says. States also have obligations under the North American Free Trade Agreement, which may preclude outright bans on outsourcing to Mexico and Canada.

Stuart Anderson, executive director of the National Foundation for American Policy, a nonprofit group that does research on trade and immigration issues, contends that states don't have the legal right under the Constitution to ban offshore outsourcing. "It goes against the Foreign Commerce Clause of the Constitution and also intrudes on the right of the federal government to conduct foreign policy," he says. A state's outright ban could be tested in court, Anderson says. "What's important here is how the restrictions are practiced. There's a difference between an outright ban and preferences for doing the work inside the state," he says.

For service providers, the issue of sending public-sector work overseas is sensitive. "We're not going to send [public-sector] IT work offshore. It just doesn't fly in today's environment," says a spokesman for Tata Consultancy Services, an Indian outsourcing services provider. Tata does most public-sector work in the state where it's contracted, the spokesman says, and at least a quarter of employees must be from that state. The rest can be from outside the state or country but must work at in-state facilities. Back-office work, such as call centers, can be done outside the United States. "The biggest issue is transparency. We don't hide who we are."

Despite knee-jerk reactions by many state officials to restrict offshore outsourcing-and, in some cases, take back or renegotiate contracts-most legislators have taken a moderate approach, leaving the door open for options. "There are compelling arguments on both sides," NASCIO's Gallt says, "but most states are staying neutral. They don't want limitations."

The issue also may be less of a hot button after the election when public focus on unemployment dies down. Service providers will be ready with new public-sector outsourcing offerings. EFunds is looking at "Tier 2" benefits, which are state-administered payment programs such as Women, Infants and Children, that states may want to outsource. "We're interested in other information-management programs that states need, such as those involved with maintaining vital records," Campbell says. EFunds also is looking at providing biometrics services as a way to prevent fraud and Web-site upgrades that increase citizen access to important documents such as motor vehicle records.

Not all this work can or will go offshore, but the opportunity to send it there will continue to entice states faced with taxpayers' demands for more services at lower costs. "There's a delicate balance to maintain," Maine CIO Thompson says. "There's the cost of services versus the political ramifications. The cost of offshore development is generally less than what we pay, but it's not an easy decision." Juggling the cost savings against political fallout will continue to challenge Thompson and other state IT chiefs trying to make the right decisions.

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STATE BY STATE: WHERE THEY STAND

Laws Passed

Alabama: Encourages use of in-state professional services

Indiana: Preference for in-state companies in that their pricing can be 1% to 5% above outsiders'

Massachusetts: Prohibits outsourcing of any functions that state employees currently perform

Tennessee: Preference for in-state companies offering data-entry and call-center services

Pending Legislation

Would ban overseas work: Alabama, Arizona, California, Colorado, Connecticut, Georgia, Hawaii, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Michigan, Mississippi, Missouri, Nebraska, New Jersey, New Mexico, New York, North Carolina, Ohio, Rhode Island, South Carolina, South Dakota, Vermont, Virginia, Washington, Wisconsin

Delaware: Companies would have to disclose that work would be done offshore; 15% preference for U.S.-based work

Florida: In-state residence would be required to win state contracts

Idaho: State residents would get preference for state jobs

Pennsylvania: Investigation of offshore contracting would be launched

West Virginia: Restrictions would be placed on the use of call centers, including a seven-year ban on the state using contractors whose outsourcing of work overseas would result in 100 or more people losing their jobs

Executive Orders

Arizona: Prohibits new state contracts that would send work overseas

Florida: Mandates on investigation of the impact of offshore outsourcing

Michigan: Provides that state funds not be used as incentives or encouragement for companies to go offshore

Minnesota: State contracts must be given to vendor providing "best value," which takes into account where work is to be performed

Missouri: No state contracts will be given to companies that plan to have offshore workers

Data: National Foundation for American Policy, National Conference of State Legislatures, individual states

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