Econ 340

Lecture 22
Outsourcing and Offshoring

Outline:
Outsourcing and Offshoring
• Definitions of OS
• Causes of OS
• Effects of OS
• Facts about OS
• Policies

Definitions
• Outsourcing = Movement of an activity to outside of firm
  (Not necessarily outside country)
• Offshoring = Movement of an activity to outside of country
  (Not necessarily outside firm)
  - Could be
    • Subsidiary abroad (FDI)
    • Subcontracting with another firm
    • Arm’s-length trade
  - Often refers to services
  - Sometimes called “trade in tasks”
Definitions

• Both could be called:
  \[ \text{OS} = \text{OutSourcing} / \text{OffShoring} \]

• I’ll use “OS” here to refer only to OffShoring, since that’s the one that is clearly international

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Causes of OS

• Blinder identifies two causes of the increase in OS over recent decades:
  – New technologies
    • Information
    • Communication
  – Entry of new populations into world economy
    • China
    • India
    • Former Soviet states
  – These make OS possible for jobs that can be done at a distance
Causes of OS

• Otherwise, causes of OS are same as causes of other trade
  – Activities are offshored if they can be done more cheaply elsewhere
  – Thus OS occurs due to
    • Comparative Advantage
      – Due to technology differences
      – Due to factor-endowment differences
    • Economies of Scale

Outline: Outsourcing and Offshoring

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Effects of OS

• Disagreements
  – Bivens (not assigned), like other trade skeptics,
    • is largely negative
    • He defines offshoring as "substituting foreign for domestic labor"
  – Many mainstream trade economists
    • see offshoring as ordinary trade
    • are largely positive
  – Blinder (a very well-respected macro economist)
    • sees OS as beneficial overall
    • but worries about effects on US labor
Effects of OS

• Effects that are Like trade:
  – All of the effects of trade that we have studied, are valid for this. OS is trade.
  – Thus
    • Countries as a whole gain, due to comparative advantage, economies of scale, etc.
    • Some people within the countries lose – especially those whose jobs are lost
    • Theory says that “scarce factors” are hurt by trade, and thus also by offshoring.

• Effects that are Unlike trade
  • i.e., effects that don’t occur with other trade, or at least weren’t mentioned
    – Increased insecurity: workers feel more threatened
      • New groups (white collar, in high-income countries) are seeing the threat
    – Employers can “move jobs”; workers can’t
      • Thus employers gain in bargaining over wages

• Effects that are Unlike trade
  – (Possible) loss of technological advantage
    • Poor countries acquire the knowledge that rich countries previously had exclusively.
    • Thus
      – Poor countries become more productive
      – Their incomes rise
      – Therefore OS helps economic development
Effects of OS

- Effects that are **Unlike** trade
  - (Possible) loss of technological advantage
    - Terms of trade of rich countries worsen, costing them some of their gains from trade
    - Thus rich countries may lose from the loss of exclusive technologies due to OS
    - But what they are losing are the gains from trade. Refusing to trade would only make things worse.

- OS from US may create jobs in US
  - OS can make a firm or industry viable that would not have been viable without OS
  - Example: US software company, IMC.
    - (IMC = Information Management Consultants. Makes software to exploit human genome research.)
    - Became viable only with coding done in India.
    - Later it employed six engineers in the US for every one in India.

- OS raises productivity (see Amiti and Wei)
  - They estimated the causes of US productivity growth over 1992-2000
    - 11% of it was due to “service offshoring”
    - Only 3-6% was due to imported material inputs
  - Why the gain? Because firms choose to offshore the less efficient parts of what they do.
Effects of OS

- OS threatens some occupations more than others (see Blinder’s examples)

<table>
<thead>
<tr>
<th>Offshorable</th>
<th>Not offshorable</th>
</tr>
</thead>
<tbody>
<tr>
<td>electronic service</td>
<td>personal service jobs</td>
</tr>
<tr>
<td>tax accounting</td>
<td>onsite auditing</td>
</tr>
<tr>
<td>computer programming</td>
<td>computer repair</td>
</tr>
<tr>
<td>architects</td>
<td>builders</td>
</tr>
<tr>
<td>radiology</td>
<td>pediatrics and geriatrics</td>
</tr>
<tr>
<td>lawyers who write contracts</td>
<td>litigators who argue cases in court</td>
</tr>
</tbody>
</table>
Facts about OS

- But the actual amount is still relatively small
  - Brainard and Litan say OS accounts for only 2% of those who involuntarily lose their jobs. (It would be a much smaller share of all job turnover)
  - But they were writing in 2004
  - One more recent source, though critical of OS, seems to give an even smaller estimate.

Another source, also critical of offshoring, shows the chart on the next slide
- Their point is that a lot of US imports (about 50%) is related party trade, and thus OS
- But the chart does not show much growth since the data of Brainard and Litan
Facts about OS

- OS is moving into **services**
- There are flows in **both directions**
- Flows *out of US* are mostly low value jobs
  - So far. But Blinder worries & sees threats to higher value jobs

Facts about OS

- Brainard and Litan say OS is **not shifting** the proportion of incomes more towards **profits**
  - See graph below

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**Figure 2:**
U.S. Corporate Income Relative to Worker Income 1960-2005

Source: The Economic Report of the President, 2004
Facts about OS

• Brainard and Litan say OS is not shifting the proportion of incomes more towards profits
  – See graph below
  – Other data (below) show that labor’s share
    • Has declined in recent decades
    • Increased in the crisis, as profits fell
    • Then fell in recession
Tom Friedman’s View of OS

• Tom Friedman (author of *The World Is Flat*)
• CEOs no longer think of outsourcing (or offshoring) at all, because
  – They don’t think of “in” or “out”
  – Things are “Made in the World”
  – They produce “anywhere through global supply chains”

Friedman thinks the US has advantages that will let us prosper in this new world:
– protection for intellectual property
– secure capital markets
– government funding for science
– strength in logistics (FedEx, UPS)

Facts about OS

• Recently, some offshoring has been reversing (see Economist):
  – Some companies are bringing operations back to the US
  – Called “reshoring”
Facts about OS

• Examples of reshoring
  – General Electric has “returned production of fridges, washing machines and heaters from China back to Kentucky.”
  – Lenovo is starting to make PCs in North Carolina
  – GM is shifting its IT back to Detroit
  – Apple is making some Macs in the US

• Reasons for reshoring
  – China’s cost advantage is shrinking due to
    • Rising wages
    • Appreciating currency (until recently)
  – Increased use of automation (robots) has reduced reliance on labor
  – Production abroad is increasingly to serve foreign markets, not to export back to US

• Most recently – see Schuman NYT 2016
  – While US did lose jobs to China before 2011, now China itself is losing jobs:
    • Due to its slowing economy
    • To
      – Its neighbors
      – Back to the US
Facts about OS

- Most recently – see Schuman NYT 2016
  - While US did lose jobs to China before 2011, now China itself is losing jobs
  - Why?
    - Wages in China are 29% higher than 3 years ago
    - Wages are lower in
      - Vietnam (1/2)
      - Bangladesh (1/4)
    - Costs in China are now about the same as in US

Facts about OS

- Most recently – see Schuman NYT 2016
  - While US did lose jobs to China before 2011, now China itself is losing jobs
  - Why?
    - Where are jobs from China going?
      - To neighboring low-wage countries
      - Back to US: Survey found 24% of US manufacturers "reshoring" or planning to
      - Apple’s manufacturer, Foxconn, is building 12 new factories in India

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Policies Suggested for OS

- Get more data
- Expand adjustment assistance
- Invest more in education
- Require transparency by publicly owned firms.
- Remove artificial (i.e., tax) incentives that encourage OS.

Policies Suggested for OS

- Trump:
  - Provide tax incentives to keep production here (as done in fall 2016 for Carrier)
  - Threaten a tax on exports back to US from OS factories
  - Good ideas? NO!

A final note on Outsourcing

- [http://www.youtube.com/watch?v=rYaZ57Bn4pQ](http://www.youtube.com/watch?v=rYaZ57Bn4pQ)
Next Time
(Last Lecture; Next-to-Last Class)

- Environment, Labor Standards, and Trade
  - The Issues
  - Environment
    - Examples
    - Policies
    - International Problems
    - Role of the WTO
  - Labor Standards
    - Fundamental ILO Conventions
    - United States Role
    - Issues