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”

Outline: Outsourcing and Offshoring

- Definitions of OS
- Causes of OS
- Effects of OS
- Facts about OS
- Policies

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

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 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.

- 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>

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Facts about OS

- Blinder estimates that 30-40 million US jobs are potentially offshorable.
  - Compare to civilian employment in Jun 2008: 145.9 million
  - So Blinder is estimating that up to a quarter of US employment is potentially threatened by offshoring
  - Thus it “rattles” him
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

• 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

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

Figure 1:
U.S. imports driven by trade between related corporate entities
U.S. manufacturing and total economy related-party imports as a share of respective overall U.S. imports
- Total related-party share
- Primary metals, machinery, and transportation manufacturing
- Food, textiles, apparel, and transportation manufacturing


Figure 2:
U.S. Corporate Income Relative to Worker Income 1968-2003

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

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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”

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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
  - 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

- 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