

Study Questions
(*with Answers*)

Lecture 22
Outsourcing / Offshoring

Part 1: Multiple Choice

Select the **best** answer of those given.

1. Outsourcing is
 - a. Exporting
 - b. Importing
 - c. A firm having someone else do part of what it previously did itself.
 - d. Building a factory in another country to produce for that country's market.
 - e. Going out of business

Ans: c

2. Offshoring is
 - a. Substituting foreign for domestic labor.
 - b. Subcontracting a part of production to another firm.
 - c. Exporting
 - d. Importing
 - e. Building a factory in another country to produce for that country's market.

Ans: a (This is the definition quoted in lecture from Bivens)

3. According to the Brainard and Litan Policy Brief, what percentage of those in the U.S. who involuntarily lose their jobs each year do the authors estimate are due to offshoring?
 - a. None. Outsourcing has no effect on employment.
 - b. None. Outsourcing actually causes employment to increase.
 - c. Less than five percent.
 - d. Between ten and twenty percent.
 - e. More than half.

Ans: c (The Brainard-Litan piece gives a number, for offshoring, 2%, of involuntary job losses.)

4. How does offshoring affect an industry's productivity?
- a. It reduces productivity by making workers anxious and unable to concentrate on their jobs.
 - b. It reduces productivity by replacing workers with low-quality machines, produced abroad.
 - c. It increases productivity by scaring workers into working harder.
 - d. It increases productivity by eliminating the activities at which the firm is least efficient.
 - e. It has no measurable effect on productivity, according to studies that have sought to measure it.

Ans: d (See Amiti and Wei.)

5. Which of the following jobs does Alan Blinder code as "offshorable"?
- a. Architects
 - b. Computer repair
 - c. Pediatrics
 - d. Geriatrics
 - e. Builders

Ans: a

6. Which of the following is **not** one of the policies recommended for dealing with outsourcing/offshoring in the United States?
- a. Gather more data about it.
 - b. Provide additional assistance to workers who lose their jobs because of it.
 - c. Repeal any tax laws that artificially increase the practice.
 - d. Prohibit imports that have been produced with foreign labor.
 - e. Provide wage insurance.

Ans: d

7. Which of the following is **not** one of advantages that Tom Friedman, in the assigned article “Made in the World,” says will allow the US to prosper in the new world where companies produce wherever they view it as most beneficial, rather than “in” or “out” of a home country?
- a. Protection for intellectual property
 - b. Low wages
 - c. Secure capital markets
 - d. Government funding for science
 - e. Strength in logistics

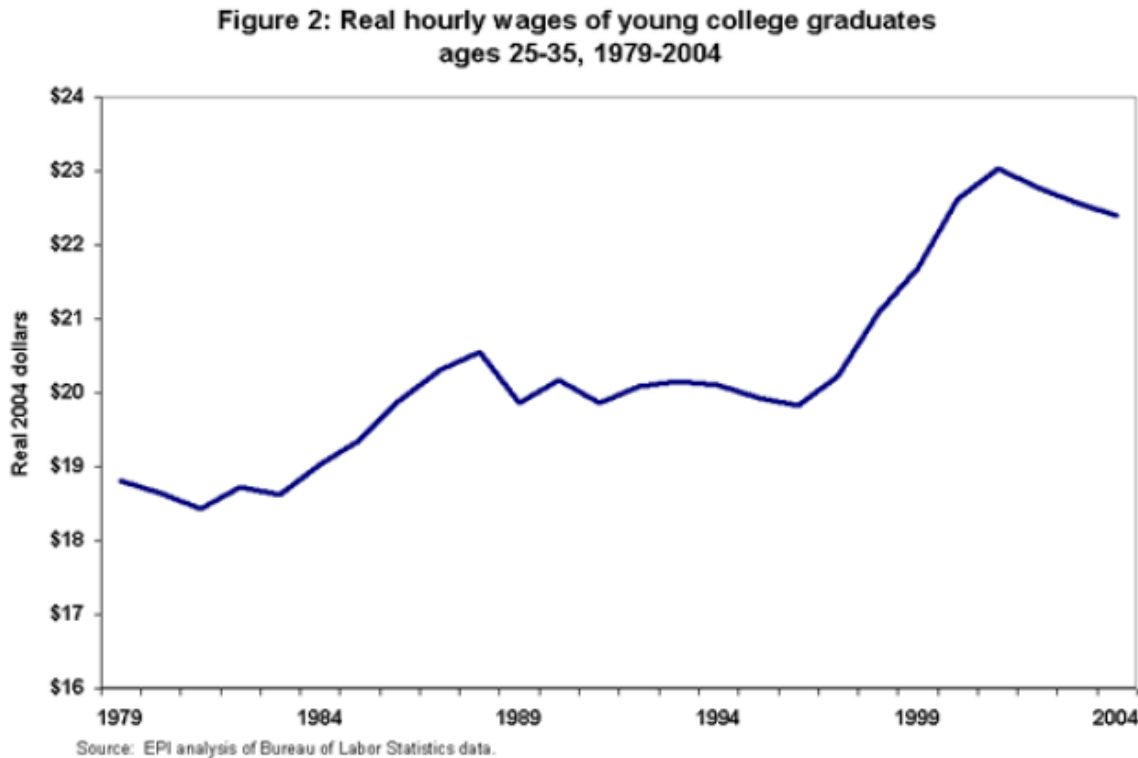
Ans: b

Part II: Short Answer

1. How could offshore outsourcing create new jobs in the U.S.?

Ans: Hiring of workers abroad can make a domestic industry viable whose costs would otherwise have been too high to survive, or even in some cases to start. See Bhagwati et al. for an example. Also (as an alternative answer), some outsourcing comes into the US and employs workers here.

2. The graph below was shown in lecture from Bivens, at the Economic Policy Institute. Which part of it is relevant to offshoring, and why?



Ans: The portion relevant to offshoring is the last several years, from 2000 to 2004, when the real wages of these young college graduates declined. This was the period, according to Bivens, when offshoring began to happen, and it is possible that the decline in wages may have been due to offshoring. Even if it was not, the decline in wages was a source of concern for these workers, leading them to suspect that they were being hurt by competition from foreign workers.

3. Suppose that the US company General Electric (GE) is initially employing 1000 US workers to make condensers for the refrigerators that it sells to consumers in the US. It pays these workers a total of \$50 million per year. It also is initially buying \$30 million worth of shelves for its refrigerators from Mexico. In each of the examples below, assume that the rest of the US economy continues to do everything that it did before, and so does GE except for the changes listed. Then, for each of examples (a)-(c), answer the following questions:
- i. From the information given, what is the change in US GDP as it would normally be measured?
 - ii. What is the change in the output that the US actually produces?
 - iii. How much of the change in GDP in (a) is therefore “Phantom GDP”?

iv. Is the US made better off, worse off, or unaffected by these changes?

- a. GE switches its purchases of shelves from Mexico to a supplier in China, which produces them for one-third the price: \$10 million.

Ans: i) Imports, M , fall from \$30 million to \$10 million, while US consumption (of refrigerators) remains the same, so $Y=C+I+G+X-M$ rises by \$20 million. ii) No production has changed in the US, so iii) all of this change is Phantom GDP. iv) As a country, the US is better off, getting cheaper imports, and the gain accrues to GE in higher profits.

- b. GE finds a way to make the same number of condensers with only 800 (US) workers instead of 1000. It therefore reassigns 200 workers, paying them the same as before, to make a new product, gePods, that it sells to US consumers for \$10 million.

Ans: i) Consumption of refrigerators is unchanged, while consumption of gePods rises by \$10 million, so GDP rises by that amount as well. ii) This time real output has truly risen by this amount, so iii) there is no Phantom GDP created here. iv) The US is again made better off, with more products to consume.

- c. GE now learns that it can manufacture the condensers in China as well, for only \$5 million. It therefore reassigns the other 800 also to making still more of the newly popular gePods, and its sales of gePods rise from \$10 million to \$50 million.

Ans: i) Consumption of refrigerators is again unchanged, but consumption of gePods rises by \$40 million, while imports rise by \$5 million. So $GDP=C+I+G+X-M$ rises by $\$40-5=\35 million. ii) Actual production, however, has not changed, since the US has reduced production of condensers by \$40 million and increased production of gePods by \$40 million. So iii) all of the \$35 million increase in GDP is Phantom GDP. Still, although we are producing no more, we are consuming more (the new product), so we are iv) better off.