

Econ 340

Lecture 22 Outsourcing and Offshoring

Outline: Outsourcing and Offshoring

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

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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"

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Definitions

- Both could be called:

OS = **Out**Sourcing / **Off**Shoring

- 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

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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

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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

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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.

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Effects of OS

- 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

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Effects of OS

- 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

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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.

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Effects of OS

- 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.

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Effects of OS

- 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.

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Effects of OS

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

Offshorable	Not offshorable
electronic service	personal service jobs
tax accounting	onsite auditing
computer programming	computer repair
architects	builders
radiology	pediatrics and geriatrics
lawyers who write contracts	litigators who argue cases in court

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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

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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.

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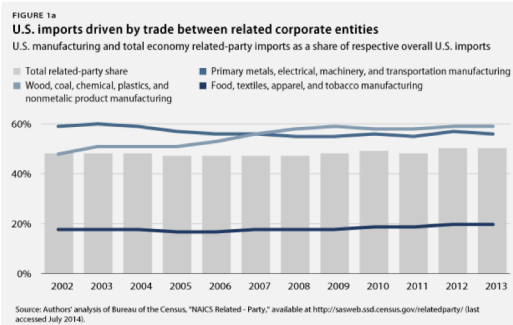
Facts about OS

- 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

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Facts about OS



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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

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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:



Source: *The Economic Report of the President, 2004*

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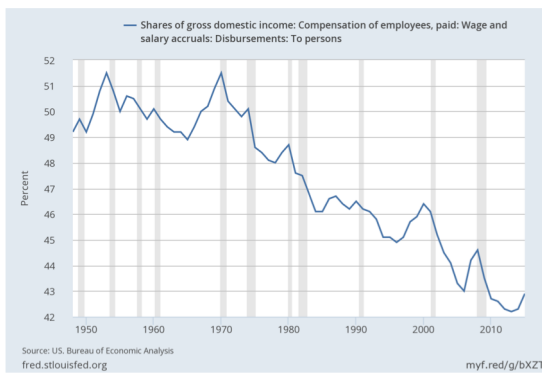
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Facts about OS

- 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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Tom Friedman's View of OS

- 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)

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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"

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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

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Facts about OS

- 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

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Facts about OS

- 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

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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

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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.

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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!

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A final note on Outsourcing

- <http://www.youtube.com/watch?v=rYaZ57Bn4pQ>

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Environment, Labor

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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

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