

Econ 340

Lecture 22

Outsourcing and Offshoring

Announcements

- Lists of Terms and Acronyms are now available to help you study
 - Go to course website under Handouts
 - All may be found in my Glossary, also online, from which I mostly cut and pasted

Economics 340

International Economics Fall 2019

Course Syllabus

Contacts: Office Hours, etc.

Curves from prior terms

Enrollment Information | (Overrides)

Exam Information

Glossary of International Economics

Handouts

Honors Assignment

Lectures: Slides

News: Assigned | Subscription Prices | All

Podcast: Trade Talks

Q&A: Questions Asked and Answered

Questionnaire Results: Winter 2018 Winter 2013

Questions on Readings

Study Questions

Useful Links

Handouts

Terms & Acronyms Listed
Terms & Acronyms Defined

Econ 340 Review: Terms and Acronyms

Terms:

Absolute advantage
Accountability
Ad valorem
Adjustment assistance
Aggregate demand
Aggregate supply
Anti-dumping duty
Appellate body
Appreciate/depreciate
Arbitrage
Asian Crisis
Asymmetric shock
Auction of quota
Autarky
Bail-in
Bailout
Banking union

Econ 340 Review: Terms and Acronyms

Terms:

Absolute advantage	The ability to produce a good at lower cost, in terms of real resources, than another country.
Accountability	The requirement that recipients of development aid be held accountable for how it is used.
Ad valorem	Per unit of value (i.e., divided by the price).
Adjustment assistance	Government program to assist workers and/or firms whose industry has declined, either due to import competition trade adjustment assistance) or from other causes.
Aggregate demand	The total demand for a country's output, including demands for consumption, investment, government purchases, and net exports.
Aggregate supply	The total supply of a country's output of all industries combined, usually assumed to be an increasing function of its price level in the short run but independent of the price level in the long run.
Anti-dumping duty	Tariff levied on dumped imports, i.e., imports that are sold for an unfairly low price.

<u>Midterm No. 1:</u>	Monday, October 21	8:30-9:50 AM	1120 Weill Hall
<u>Midterm No. 2:</u>	Monday, November 18	8:30-9:50 AM	1120 Weill Hall
<u>Final Exam:</u>	Friday, December 13	1:30-3:30 PM	1120 Weill Hall

Office Hours for the Final Exam

Prof Alan Deardorff

Monday 12/9, 10-11 AM, 3314 Weill
Thursday 12/12, 10-11 AM, 3314 Weill

GSI Huayu Xu

TBA

GSI Review session:

TBA

What's Covered on the Final Exam?

NOTE: You will get two points for correctly recording:

- your name and UMID number, both on the exam booklet and on the scantron sheet so that the computer can read it,
- **AND** your **FORM NUMBER** on the scantron so that the computer can read it.

(In other words, you will lose two points if you don't do all of this.)

The final exam is cumulative covering all of the material since the start of the course through the end. I intend to give roughly equal treatment to each lecture topic, including the outside readings and assigned news items. Thus, the exam covers:

- All assigned portions of Gerber (see [syllabus](#) on line),
- All of the readings assigned from Sep 9 through Dec 9, (including the pieces marked as "Other Views" but not those marked as "Optional"),
- You should also be familiar with the **news** that we will have discussed in class, including those items identified on the [Assigned News Items](#) page for weeks: Sep 9 through Dec 8.

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:

OS = **O**ut**S**ourcing / **O**ff**S**horing

- I'll use "OS" here to refer only to OffShoring, since that's the one that is clearly international

Clicker Question

Which of the following is offshoring?

- a) A US toy manufacturer imports steel from Brazil.
- b) A Canadian tractor producer contracts with a Toronto company to make wheels that it used to make itself.
- ✓ c) A German maker of air conditioners stops making the condensers in Munich and opens a plant in the Czech Republic to make them.
- d) All of the above.
- e) None of the above.

Outline:

Outsourcing and Offshoring

- Definitions of OS
- **Causes of OS**
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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

- Definitions of OS
- Causes of OS
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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 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
 - They see foreign workers doing jobs they used to do, often for the same employer
 - 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 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

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.

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.

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.

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

Clicker Question

Which of the following according to Blinder, contributed to the increase in offshoring during recent decades?

- a) The entry of China into the world economy.
- b) Advances in information technology.
- c) The integration of former Soviet states with countries of the west.
- ✓ d) All of the above.
- e) None of the above.

Clicker Question

Why might one expect offshoring to increase profits relative to wages?

- a) Offshoring permits sellers to increase the markup of price over cost.
- b) Governments of countries that attract offshoring provide subsidies to firms.
- ✓ c) Employers can threaten to move abroad when negotiating with workers.
- d) Companies that offshore become monopolies.
- e) Offshoring reduces wages in developing countries.

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Outsourcing and Offshoring

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

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.

Facts about OS

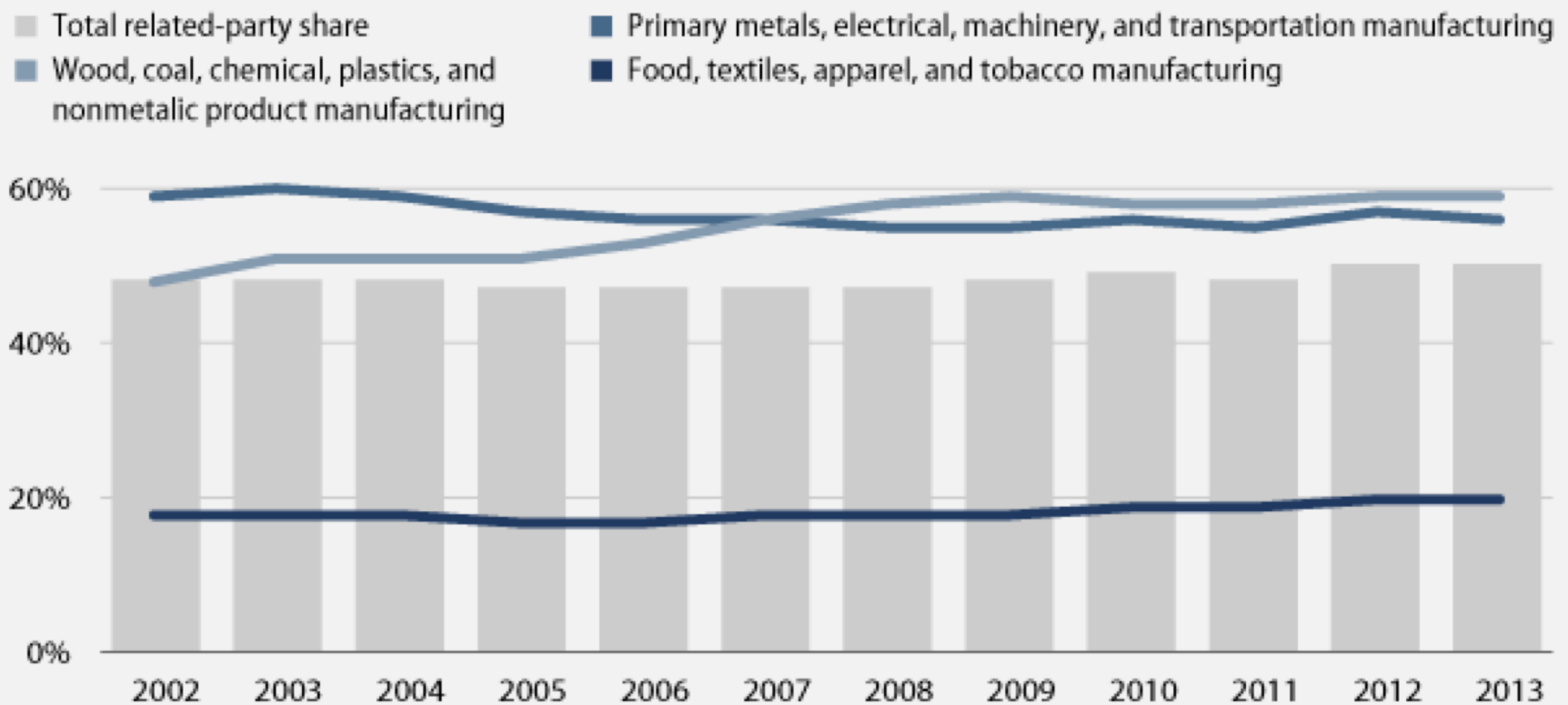
- Another source, also critical of offshoring, shows the chart on the next slide
 - Their point is that a lot of US imports (about 50%) is “related party trade,” and thus OS
 - But the chart does not show much growth since the data of Brainard and Litan

Facts about OS

FIGURE 1a

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



Source: Authors' analysis of Bureau of the Census, "NAICS Related - Party," available at <http://sasweb.ssd.census.gov/relatedparty/> (last accessed July 2014).

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, & he 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

Figure 2:

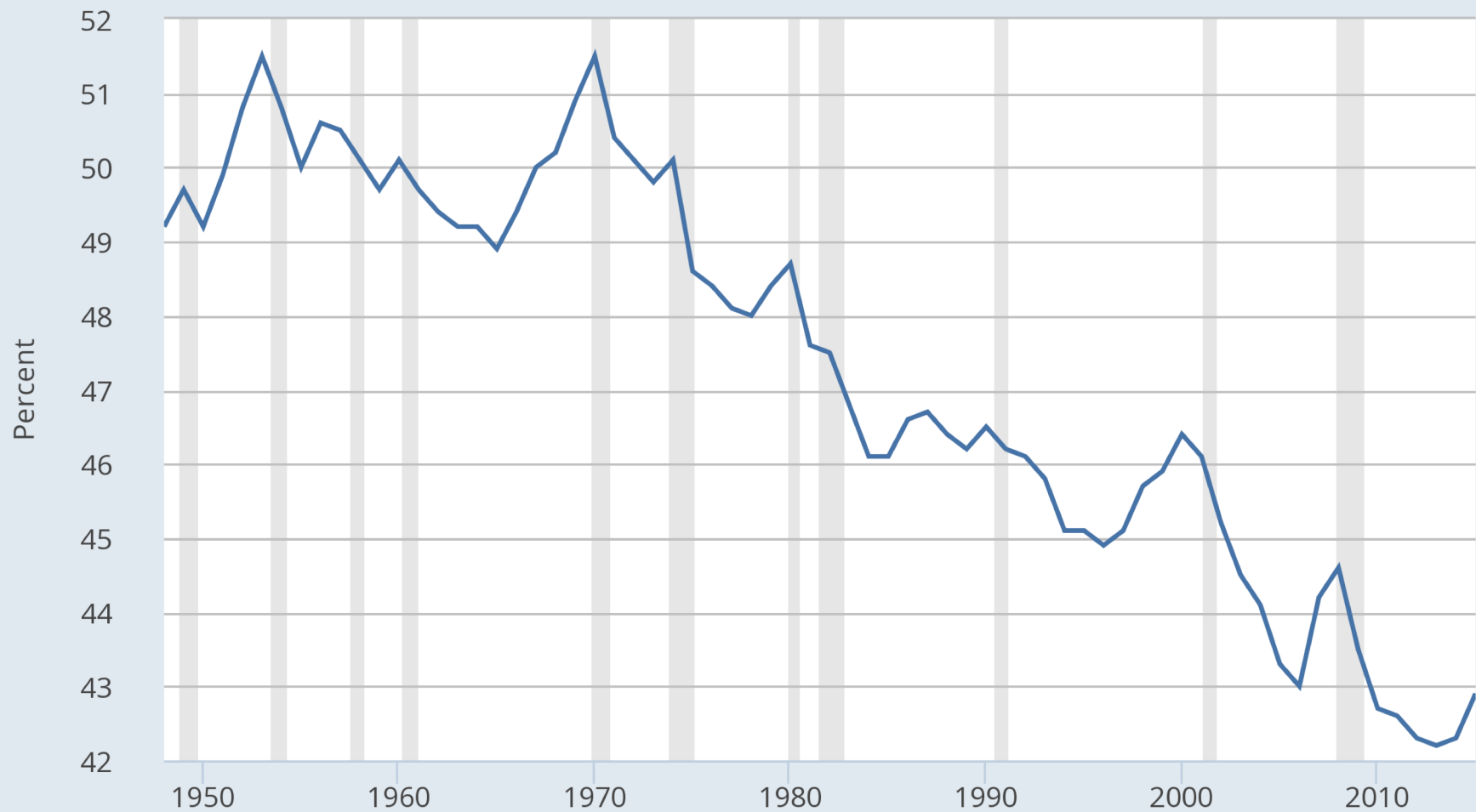


Source: *The Economic Report of the President, 2004*

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

— Shares of gross domestic income: Compensation of employees, paid: Wage and salary accruals: Disbursements: To persons

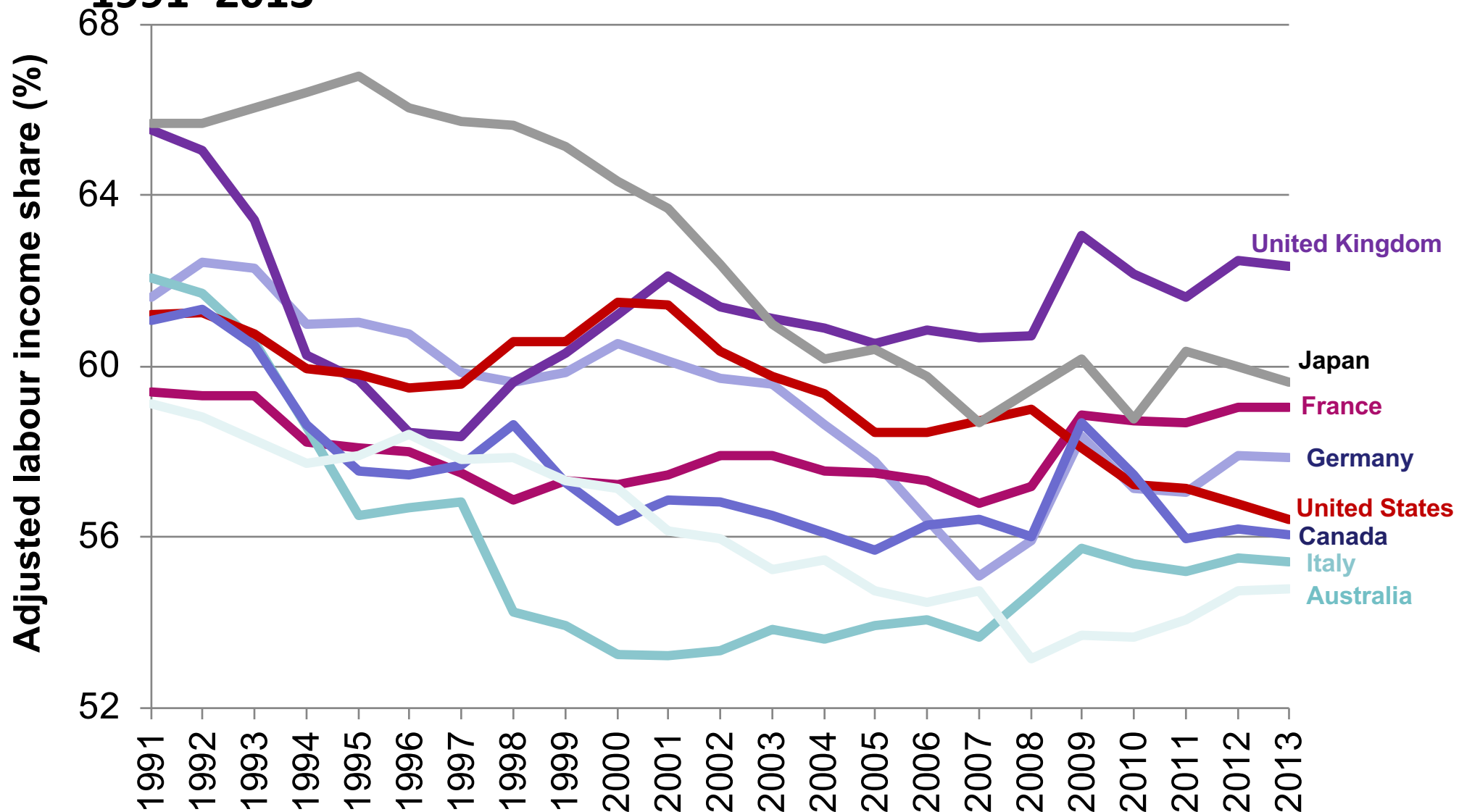


Source: US. Bureau of Economic Analysis

fred.stlouisfed.org

myf.red/g/bXZT

Adjusted labour income share in developed G20 countries, 1991–2013



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 “

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)

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

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

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

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

Clicker Question

What fraction, according to Brainard & Litan writing in 2004, of involuntary unemployment was 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.

Clicker Question

Why is China now losing jobs instead of gaining them?

- ✓ a) Reshoring.
- b) Unshoring.
- c) Offshoring.
- d) Endshoring.
- e) Upshoring.

Clicker Question

Which of the following is not one of the reasons that Friedman thinks the US will prosper in the new world of offshoring?

- a) Protection of intellectual property.
- ✓ b) Low wages.
- c) Secure capital markets.
- d) Government funding for science.
- e) Strength in logistics.

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- **Policies**

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>

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