

Outsourcing: what do we know?

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Overview some of the economics research on outsourcing/ offshoring.

- How big is it?
- Who are the gainers and losers?
- How far will it go?

How big is outsourcing/ offshoring?

Outsourcing across boundaries of countries (rather than boundaries firms).

Breadth of definition?

- Replacement of supply from local source by imports.
- Ditto, particular sectors or functions.
- Mode 1 services trade
- Use of IT to import computer/ software/ or business services.

How big is it?

Consultants' studies

- Forrester: jobs outsourced (all services, cumulative).

US: 2003: 400k

2015: 3.4 mill (including 473k IT jobs)

EU: 2015: UK 760k, DE/FR/IT 140k each

(IT only: 2004: 31k, 2015 150k)

Job turnover data

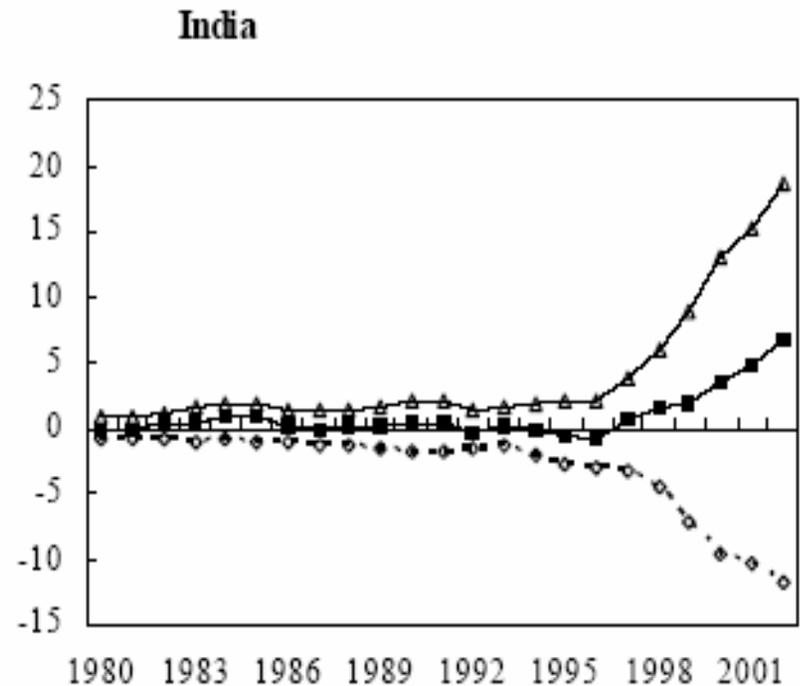
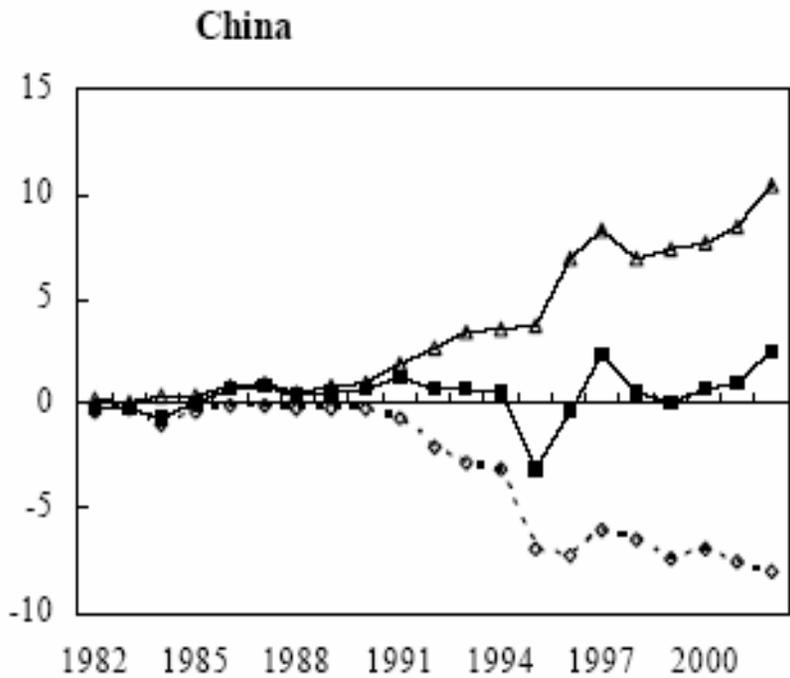
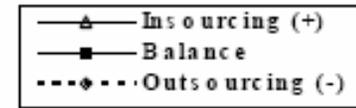
US: overseas relocation 0.88% all layoffs (Jaffee)

EU-15: relocation abroad + outsourcing 7% all layoffs

(Kirkegaard, ERM data)

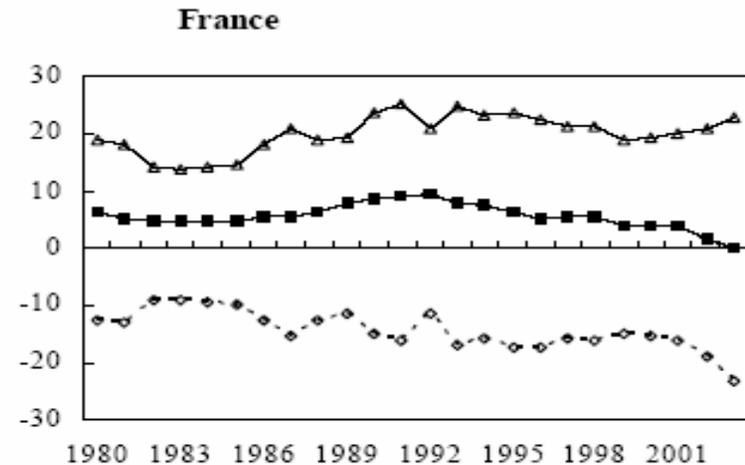
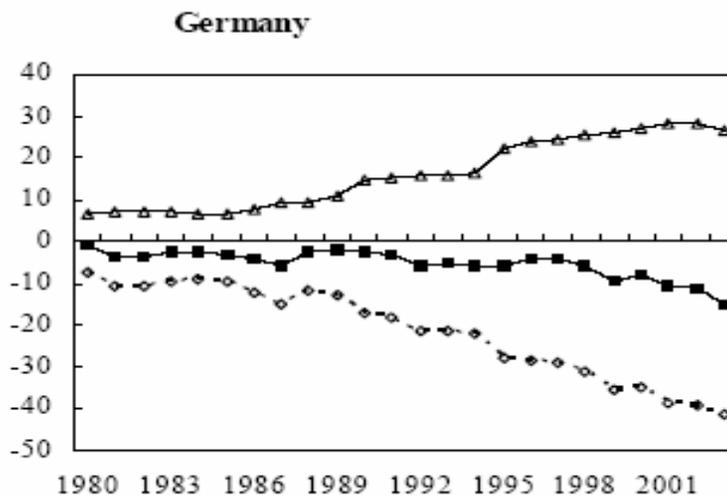
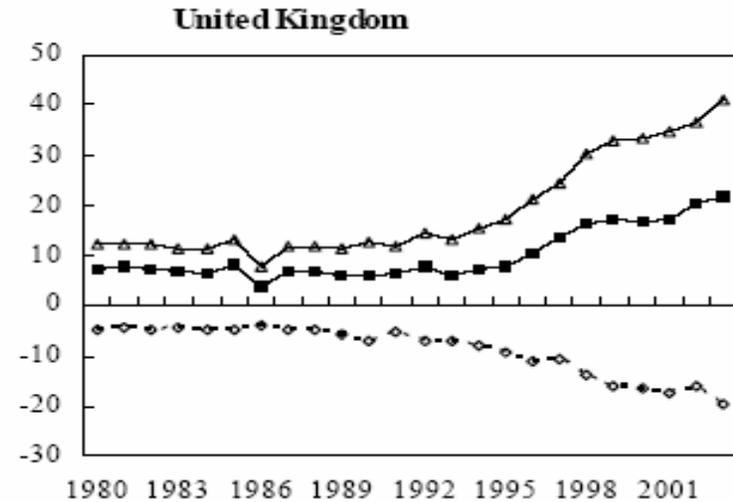
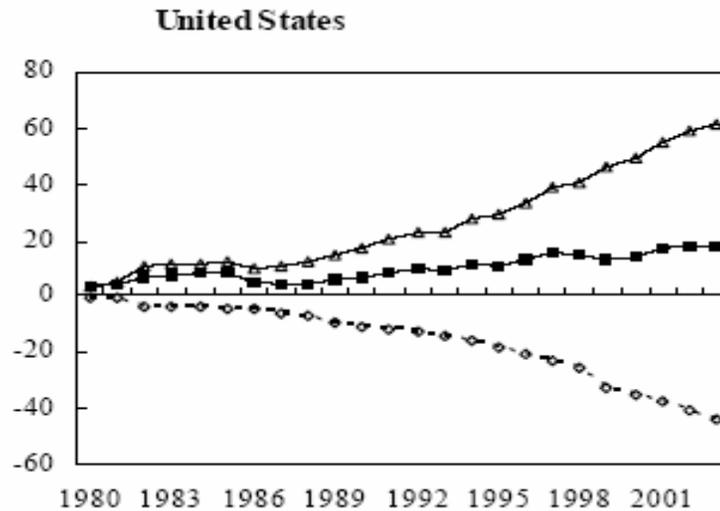
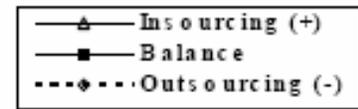
Trade data

In sourcing and Outsourcing of Business Services (billion dollars)

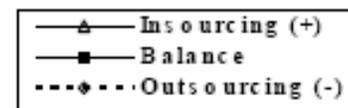


Source: Balance of Payments, IFS, IMF.

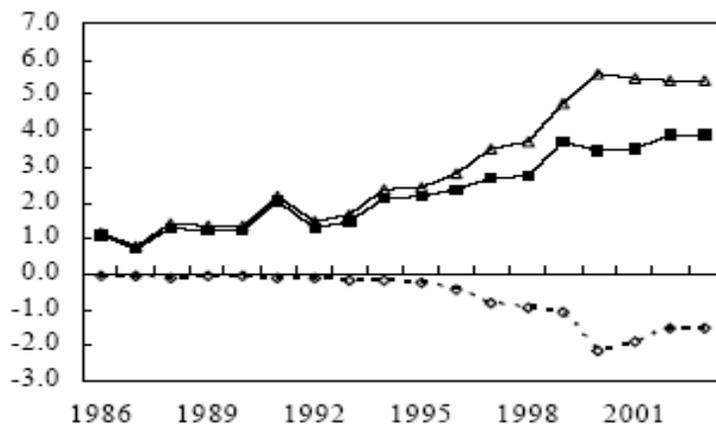
In sourcing and Outsourcing of Business Services (billion dollars)



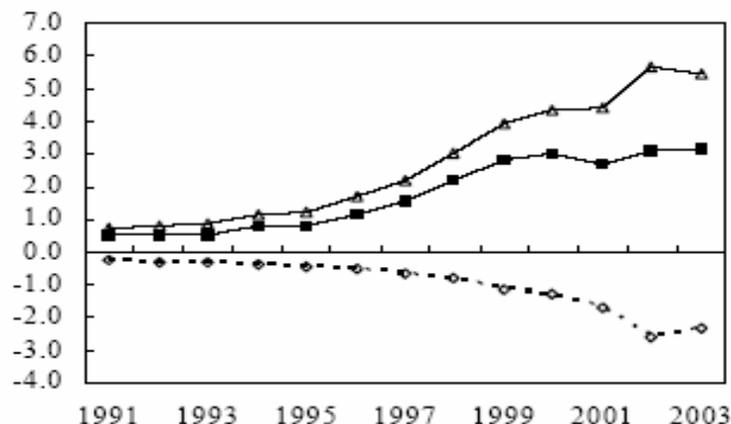
Insourcing and Outsourcing of Computer and Information Services (billion dollars)



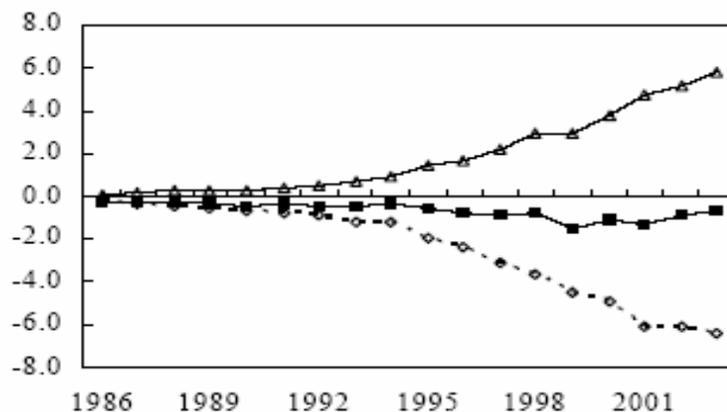
United States



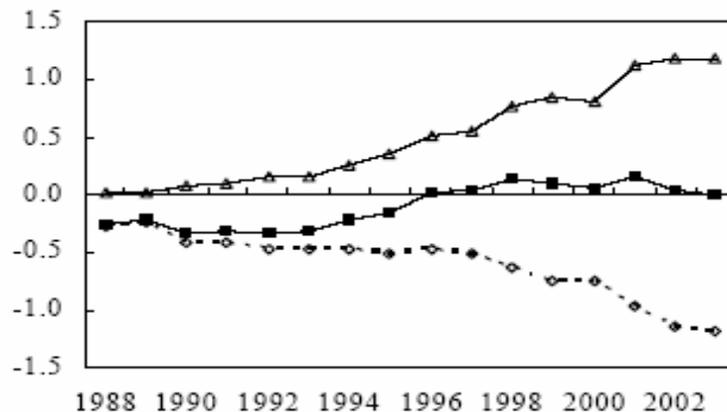
United Kingdom



Germany



France



Employment effects

- *Direct job loss (and creation)*
- *Complementarities*: Fall in the cost of one part of firm's operation should expand employment in other parts.
(NB: compared to what alternative?)
- *Jaffee (UC Berkeley)*: Identify 'at risk' occupations in US
Share total employment, 1999 = 11.4%, 2003 = 11.7%
Relative wages, 1999 = 111%, 2003 = 115%.
- *Amiti and Wei (IMF)*: Econometric study of employment in each industry as function of variables including imported inputs as % of all non-energy inputs.
US: 450 sectors, small negative effect;
when aggregate to 96 sectors, no significant effect.
UK: 78 sectors, no significant effect.

Gainers and losers: World aggregate.

World real income gain = cost saving

-- adjusted by true value of factors in alternative use.

Back of envelope calculation:

Cost saving 58% (McKinsey)

Wages of US jobs outsourced \$136 bn (2015, Forrester)

= \$80bn (cf, several \$100bn estimates of Doha round)

Value of factors in alternative use:

India: Wages > opp. cost of labour? Increase total gain.

Re-employment displaced service-sector workers

US, 69% within 6 months, similar wages

Germany, 40% (?McKinsey).

Gainers and losers: Individuals.

Re-employment of labour.

Changes in relative wages

- Theory:

Falls in real wages of some types of labour a possibility.

- Evidence:

‘At risk’ sectors – no evidence yet.

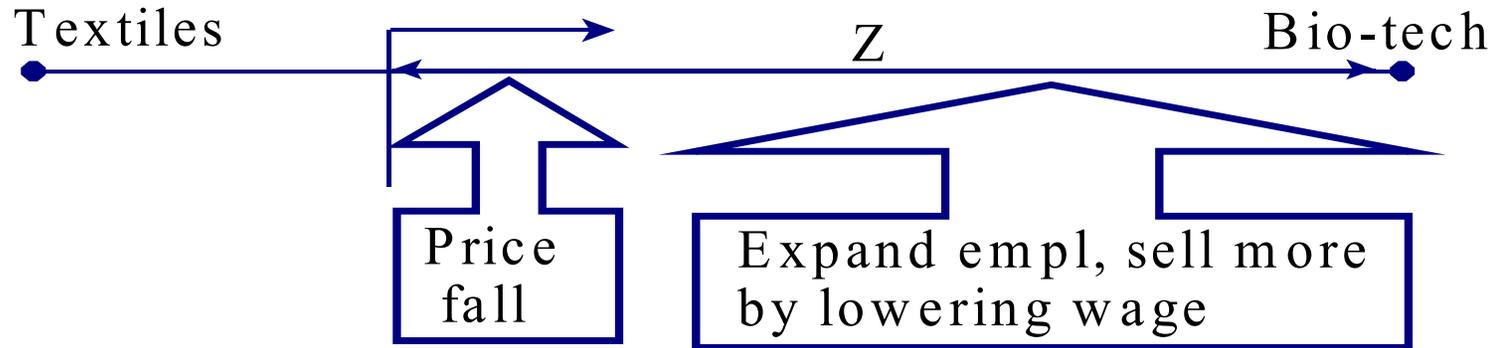
Trade and wages debate. Most of the relative decline in production worker wages in the US in the 1980s – 90s was due to technical change rather than trade.

Gainers and losers: Countries.

- Gains accrue in form of lower prices and changes in wages.
- Even if aggregate gains, *possible loss* for country that gets lower prices for its exports (terms of trade loss).
- Two things are going on:
 - Low wage countries getting access to modern technologies.
 - Trade flows following from this.

Simple model: 2 regions, North, South.

South has low wages and a technological disadvantage in fraction Z of production sectors. North has comparative advantage in these Z sectors. What happens as Z shrinks?



Effects on North:

- Loss of export sales: terms of trade loss and real income fall.
 - Loss of domestic sales: price fall, wage fall and real income gain.
 - Corollary: import protection cannot turn a loss into a gain.
- [does not protect exports, and N gains from losing domestic sales]

How far will it go?

- Tradables and non-tradables – personal services etc.
- Distance is not dead: Decline in transport costs has stopped.
Cost of time in transit is around 0.5% of the value of goods shipped, *per day*.
- Southern supply constraints: rising wages and skill shortages.
- Northern sources of ‘deep’ comparative advantage.
What activities are difficult to replicate in a new location?
Activities where there are complementarities between many skilled workers.
Within the firm – ‘capabilities’.
Within spatial clusters – cities and face-to-face contact.
- Moving the technology frontier.

Conclusions.

- Rapid recent growth of outsourcing – a two-way trade.
- Large potential gains
BUT:
gains depend on redeploying labour,
particularly in activities that are a source of
deep and/or new comparative advantage.

FELLOW ECONOMISTS - WE NEED
TO RETHINK OUR POSITION ON
OUTSOURCING.



IMPORTANT, NEW
INFORMATION HAS
COME TO LIGHT -



IT APPEARS THAT INDIA HAS
AN AMPLE SUPPLY OF CHEAP,
WELL-TRAINED...



ECONOMISTS!!

WAGGEMAN
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