

Discussion

Alho *et al.*: Offshoring, Relocation and the Speed of Convergence in the Enlarged European Union

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The paper

- Studies convergence of new EU Member States and the impact of offshoring on both NMS and EU-15

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- Studies convergence of new EU Member States and the impact of offshoring on both NMS and EU-15
- Uses a dynamic general equilibrium model with 3 regions and 2 sectors extended for FDI and migration calibrated to NMS and EU-15
- Results:
 - NMS will maintain high growth rates coupled with high inflation for the next decades
 - intensified integration leads to gains in both regions, however these gains are found to be quantitatively small

Overall

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- Relevant topic
- Interesting idea to introduce offshoring decisions into a DGE model
- Could be more focused and much streamlined: concentrate on impact of offshoring
- Many exogenous shortcuts and very specific assumptions in the model which are neither clearly discussed nor too well argued for → undermines the credibility of results

This discussion

- Concept of offshoring, outsourcing and FDI - related questions
- Miscellaneous comments

Offshoring, outsourcing and FDI - Definitions

- **Offshoring:** decision of a firm to relocate production to another country
 - *Horizontal:* relocation of the production of certain final goods of the firm
 - *Vertical:* relocation of the production of some tasks (intermediate products)
- **Outsourcing:** decision of a firm to have tasks produced beyond its boundaries
- **FDI:** capital used for offshored but not outsourced production

Offshoring, outsourcing and FDI - In the paper

- Decisions on **horizontal offshoring** by final and intermediate goods producing firms
- Assuming that **none** of the offshored production is **outsourced**
- i.e. **all** offshored production is produced with **FDI**

Offshoring, outsourcing and FDI - In the paper

- Decisions on **horizontal offshoring** by final and intermediate goods producing firms
- Assuming that **none** of the offshored production is **outsourced**
- i.e. **all** offshored production is produced with **FDI**
- Fine, but clarification and discussion of these assumptions would be useful

Offshoring, outsourcing and FDI - Model of horizontal offshoring

'Bundling' firm:

$$Y_t = CES \left(Y_t^{dom}, Y_t^{FDI} \right)$$

$$P_t^Y = markup CES \left(MC_t^{dom}, MC_t^{FDI} \right)$$

$$Y_t^{dom} = sdom \left(\frac{MC_t^{dom}}{MC_t^{total}} \right)^{-\sigma} Y_t$$

$$Y_t^{FDI} = (1 - sdom) \left(\frac{MC_t^{FDI}}{MC_t^{total}} \right)^{-\sigma} Y_t$$

Offshoring, outsourcing and FDI - Model cont'd

'Production units':

$$Y_t^{dom} = A_t^{dom} F(K_t^{dom}, L_t^{dom})$$

$$Y_t^{FDI} = A_t^{FDI} F(K_t^{FDI}, L_t^{FDI})$$

$$MC_t^{dom} = f(r_t^{kdom}, w_t^{dom}, A_t^{dom})$$

$$MC_t^{FDI} = f(r_t^{kFDI}, w_t^{FDI}, A_t^{FDI}, cro)$$

cro = costs related to offshoring

Offshoring, outsourcing and FDI - Model in paper

- This is more or less what is assumed in the paper, however:
- Labour decision is ignored
- $A_t^{FDI} = A_t^{dom}$ and identical production technology is assumed

Offshoring, outsourcing and FDI - Model in paper

- This is more or less what is assumed in the paper, however:
- Labour decision is ignored
- $A_t^{FDI} = A_t^{dom}$ and identical production technology is assumed
- Consequently, only the decision of investing capital abroad as a function of offshoring costs is modelled
- Is this really the relevant factor you are capturing?

Offshoring, outsourcing and FDI - Comments cont'd

- **Offshoring vs. importing:** only difference captured in the model is the ownership of capital - could you explain the mechanism in the model through which this plays a role? For who, how and how much? Any welfare implications?
- Is the assumption of $\mathbf{A}_t^{FDI} = \mathbf{A}_t^{dom}$ realistic?
- **Impact on employment** is a major concern about relocation in the home-countries and it is also believed an important gain for the receiving countries - it would be interesting to address these issues

Offshoring, outsourcing and FDI - Comments cont'd

- Discussion:
 - Clarification of mechanisms driving offshoring and the implications of it would be useful
 - What is the impact of productivity growth on offshoring
 - What is the impact of offshoring on capital (and labour) in NMS and EU-15?
 - Role of taxation may be interesting to explore in future
- Results: comparison does not show how large an increase in FDI implies the increase in GDP in both regions - fair evaluation would be $\Delta (GDPgrowth) / \Delta FDI$

Miscellaneous comments

- Reservations about the model:
 - 'demand-endowment' economy - market clearing condition is disconnected from investment and consumption decisions
 - 'labour market disconnect' - what role for immigration/emmigration?
 - price setting decisions not entirely clear, interest rate developments are ignored

Miscellaneous comments

- Reservations about the model:
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 - price setting decisions not entirely clear, interest rate developments are ignored
- Results:
 - Speed of convergence: interesting β -convergence
 - Quantitatively, what role does FDI play in TFP growth? How sensitive are the results to the calibration? In how far can the speed of convergence be considered endogenous?
 - Result on high inflation: how sensitive is it to specific model-assumptions?