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

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The paper

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- Uses a dynamic general equilibrium model with 3 regions and 2 sectors extended for FDI and migration calibrated to 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

- Relevant topic
- Interesting idea to introduce offshoring decisions into a DGE model
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- 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:

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

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

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

\[ Y_t^{FDI} = (1 - sdom) \left( \frac{MC_t^{FDI}}{MC_t^{total}} \right)^{-\sigma} Y_t \]
Offshoring, outsourcing and FDI - Model cont’d

'Production units’:

\[
Y_t^{\text{dom}} = A_t^{\text{dom}} F \left( K_t^{\text{dom}}, L_t^{\text{dom}} \right)
\]

\[
Y_t^{\text{FDI}} = A_t^{\text{FDI}} F \left( K_t^{\text{FDI}}, L_t^{\text{FDI}} \right)
\]

\[
MC_t^{\text{dom}} = f \left( r_t^{k\text{dom}}, w_t^{\text{dom}}, A_t^{\text{dom}} \right)
\]

\[
MC_t^{\text{FDI}} = f \left( r_t^{k\text{FDI}}, w_t^{\text{FDI}}, A_t^{\text{FDI}}, \text{cro} \right)
\]

cro = costs related to offshoring
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
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- 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 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 $A_{t}^{FDI} = A_{t}^{dom}$ 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.
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 $\Delta (GDP_{growth}) / \Delta FDI$
Reservations about the model:

- 'demand-endowment' economy - market clearing condition is disconnected from investment and consumption decisions
- 'labour market disconnect' - what role for immigration/emigration?
- Price setting decisions not entirely clear, interest rate developments are ignored
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Results:

- Speed of convergence: interesting $\beta$-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?