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**Notes on Offshoring and Outsourcing**

1. Definitions and Magnitudes
2. Causes and Predictions
3. Policy Implications

## 1. Definitions and Magnitudes

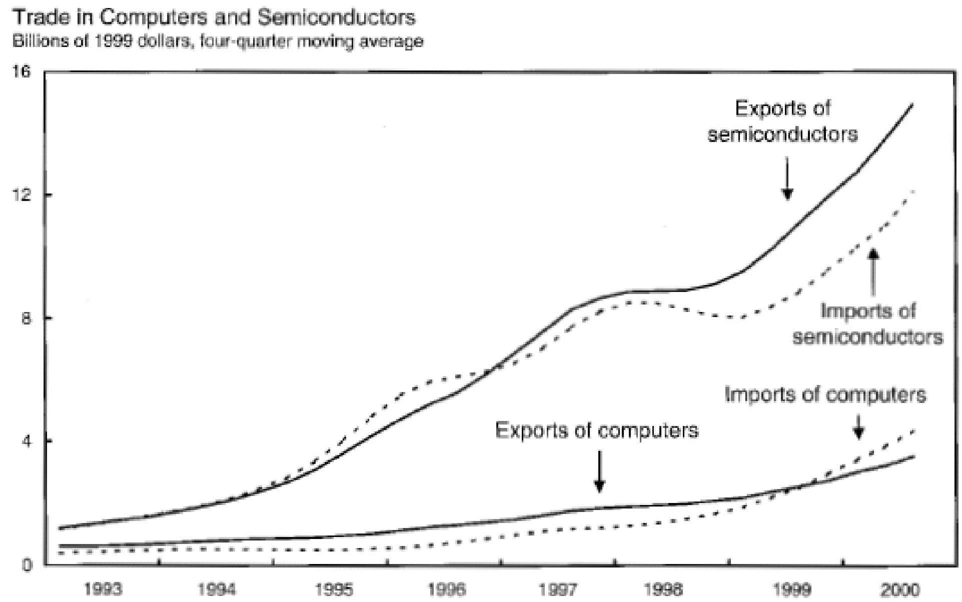
- Offshoring: moving production (of either goods or services) outside of the domestic economy. Offshoring might or might not involve trade with offshore subsidiaries; the firm could contract with foreign firms.

> "There is no official definition of the term "offshoring". But it has come to mean, in the media and in common parlance, the actions of American firms in relocating some part of their domestic operations to a foreign country -- automobile firms switching purchases of auto parts from domestic plants to Mexico; the transfer of call centers and sofware development to India; financial firms relocating major parts of their record-keeping activities to one of the Caribbean countries, and so on. In some cases the offshoring firms locate the overseas production in foreign affiliates which they own and control. Some fraction of the value of the firm's domestic sales now consists of intermediate goods or services imported from foreign affiliates rather than produced in the United States" (Schultze, 2004).

- Outsourcing: moving activities (either production or services related) outside of the boundaries of the firm by contracting.

- Offshore outsourcing: Outsourcing activities offshore.

Magnitude of offshoring in IT equipment: This has been increasing. Mann (2003) argues that offshoring of IT equipment production has yielded 10%-30% lower prices for IT equipment.




Sources: Department of Commerce (Bureau of the Census and Bureau of Economic Analysis) and Department of Labor (Bureau of Labor Statistics).

**Globalization has opened foreign markets to U.S. producers of information technology goods and expanded U.S. purchases from abroad.**

Magnitude of services offshoring: Forester estimates 3.3 million business processing jobs will be performed offshore by 2015. Place in context, current labor force of 150 million, and current IT white-collar labor force. Each *month*, 2 million workers change there jobs.


**Tomorrow's giants?** 5

India's top IT-services firms, 2004*

| | Total revenue $bn | Market capitalisation Oct 29th, $bn | Employees '000 |
|---|---|---|---|
| TCS | 1.62 | 12.17 | 40.9 |
| Wipro | 1.34 | 10.13 | 32.0 |
| Infosys | 1.08 | 11.26 | 32.9 |
| HCL Tech† | 0.57 | 2.38 | 16.4 |
| Satyam | 0.57 | 2.62 | 15.6 |

*Financial years ending March
†Financial years ending June

Sources: Company annual reports; Thomson Datastream

**2. Causes and Predictions**

- Why is offshoring occurring? This is merely the result of changing comparative advantage, so there is nothing new there.
- Why is outsourcing occurring? Firms are specializing ("focusing on core activities") and many activities formerly undertaken within firms have been contracted out.
- Why is *services* outsourcing and *services* offshoring occurring? Because of decreasing telecommunications costs.
- Note that on net, net services trade is not deteriorating for the United States. Hence, while service imports are increasing, so too are service exports.

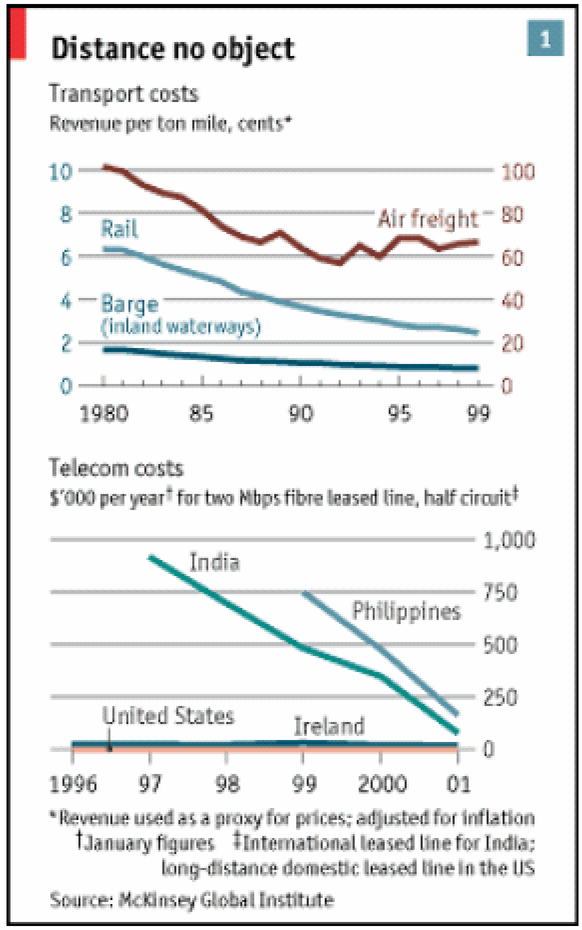
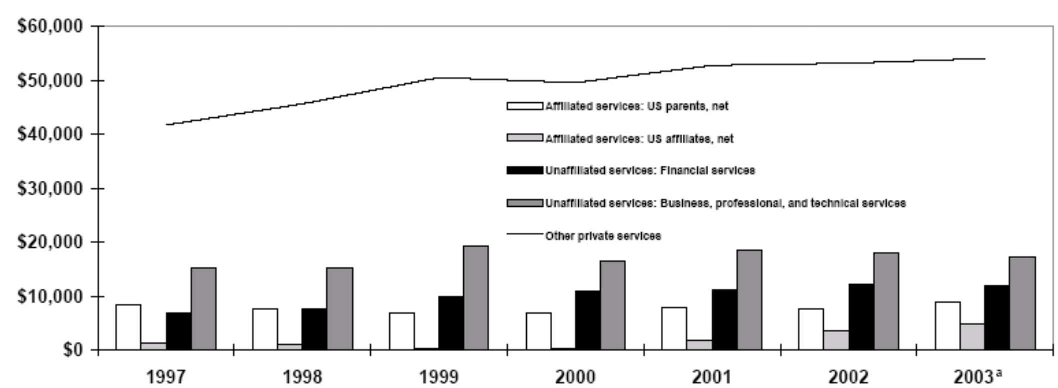



**Figure 2: Balance of trade in US other private services trade categories** (millions of dollars)



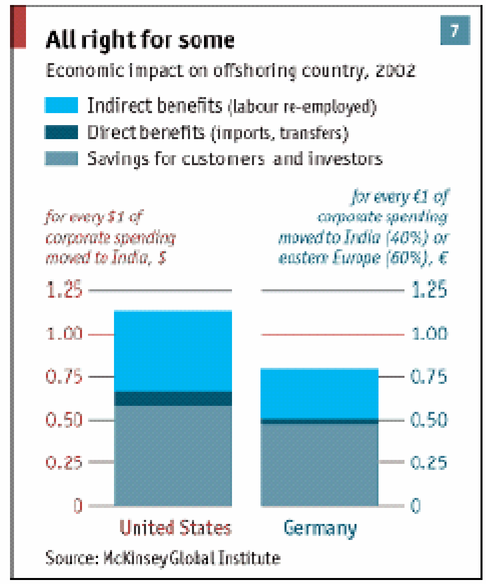

ª Annualized from 2003 Q1 and Q2 seasonally adjusted data.

*Source:* Bureau of Economic Analysis, Department of Commerce, US International Transactions table 3, US private services transactions.

Source: Economic Report of the President, 2001.

## 3. Policy Implications

To the extent that offshoring reflects comparative advantage, then it would be counterproductive to try to stop it.




More concretely, think of the offshoring process in the following way. By shifting a job offshore where it can be undertaken more cheaply, resources (including labor) are freed up to undertake more productive activities. This is the idea in the figure to the right.

Notice that for each $1 in US corporate spending shifted offshore, the US benefits to the amount of $1.14. In Europe, each €1 yields €0.77. The difference is attributed to the lower re-employment rate in Germany (only 40% of displaced are re-employed).