

**The nature of offshoring of business
services and its labour market
consequences**

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What is special about trade in business services?

□ Low frictions

- IT has led “natural” trade frictions to be extremely low.

- Many services do not require face-to-face interaction
- Language may still be crucial factor

- Excluding professional services, policy-imposed frictions are also very low.

□ Fast-growing component of services trade

What is special about trade in business services?

- Involves white-collar occupations
 - Market integration affects workers that previously have been sheltered from international competition.
- Involves tasks carried about by skilled labor
 - Integration of large low-wage economies in world economy (China, India) creates opportunities for cost-reducing offshoring of activities that may affect relative wages differently from other trade.
 - Knowledge important component.
 - Contract incompleteness important for mode of supply.
 - A large share of mode 1 supply is related to trade between affiliated parties (main share for US imports of C&IS in recent years).

Is the effect on the labour market a "Big Deal"...

- Blinder (2007) estimates that about a quarter of all US jobs potentially offshorable and that having the most offshorable occupations leads to 14 percent lower wages.
- Stresses that workers carrying out impersonal services are at the losing end.
- Stresses that the *transition* to a new equilibrium (with clear gains from trade) may be a bumpy ride.

...or "Much Ado About Nothing"?

- Liu and Trefler (2008) estimates that if trade in business, professional and technical services continues the next nine years as in 1996-2005, workers in exposed occupations would:
 - switch 4-digit occupations 2 percent less often
 - spend 0.1 percent less time unemployed
 - earn 1.5 percent more
- Studies by Amiti and Wei (2005, 2006) at industry level find small employment effects.
- Study by Hijzen, Pisu, Upward and Wright (2008) at firm level for the UK find:
 - no evidence that importing intermediate services is associated with job losses or greater worker turnover.
 - that firms which start importing intermediate services have faster employment growth than equivalent firms which do not.

Is service offshoring about trade in tasks?

- Grossman and Rossi-Hansberg (2006) emphasize that offshoring results in trade in tasks.
 - Correlation between offshorability and skill content of task may be low (and may be positive)
 - Correlation between Blinder's offshorability index and education is 0.08
 - Even if offshorable tasks tend to be carried out by low-skilled labor, low-skilled workers may be the winners in general equilibrium.

Preliminary evidence on service FDI and the composition of tasks

- Becker, Ekholm and Muendler (2008) study German multinationals based on linked employer-employee data.
- They measure tasks by creating mapping between task intensity and occupations based on German job survey.
- They find that an expansion of employment abroad is associated with an increased relative demand for...
 - *non-routine* tasks and...
 - ...tasks that require *personal interaction* with parent firm employees or the firm's customers.

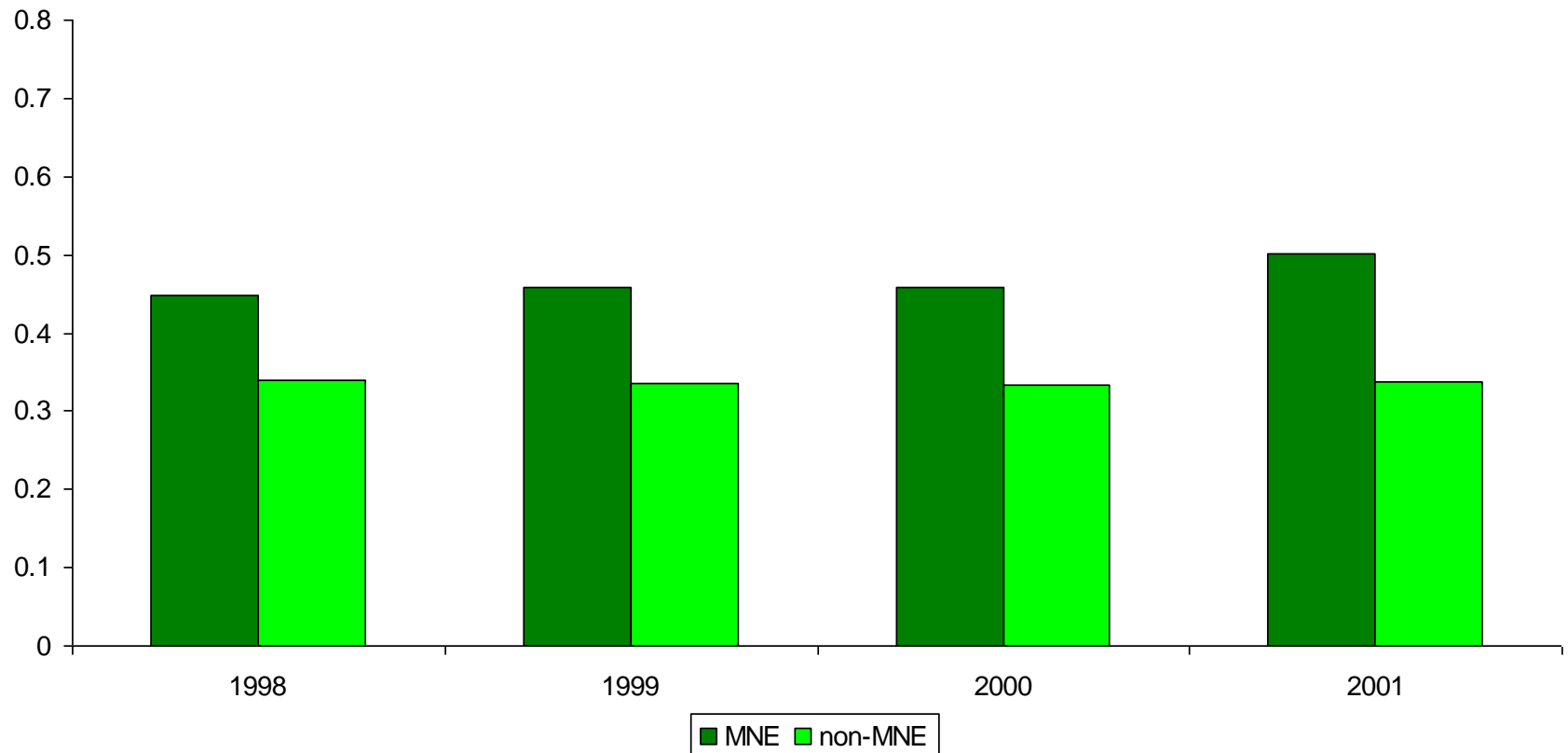
Preliminary evidence on service FDI and the composition of tasks

- They also find that it is associated with an increased relative demand for highly education workers.
 - Over and beyond what is explained by task recompositioning.
- Quantitatively, however, the 'effect' seems small at the 'intensive' margin.
 - The change in foreign exposure of service firms explains a few percentages of observed increase in the relative demand for non-routine and interactive tasks (when controlling for fixed plant and time effects).

Preliminary evidence on service FDI and the composition of tasks

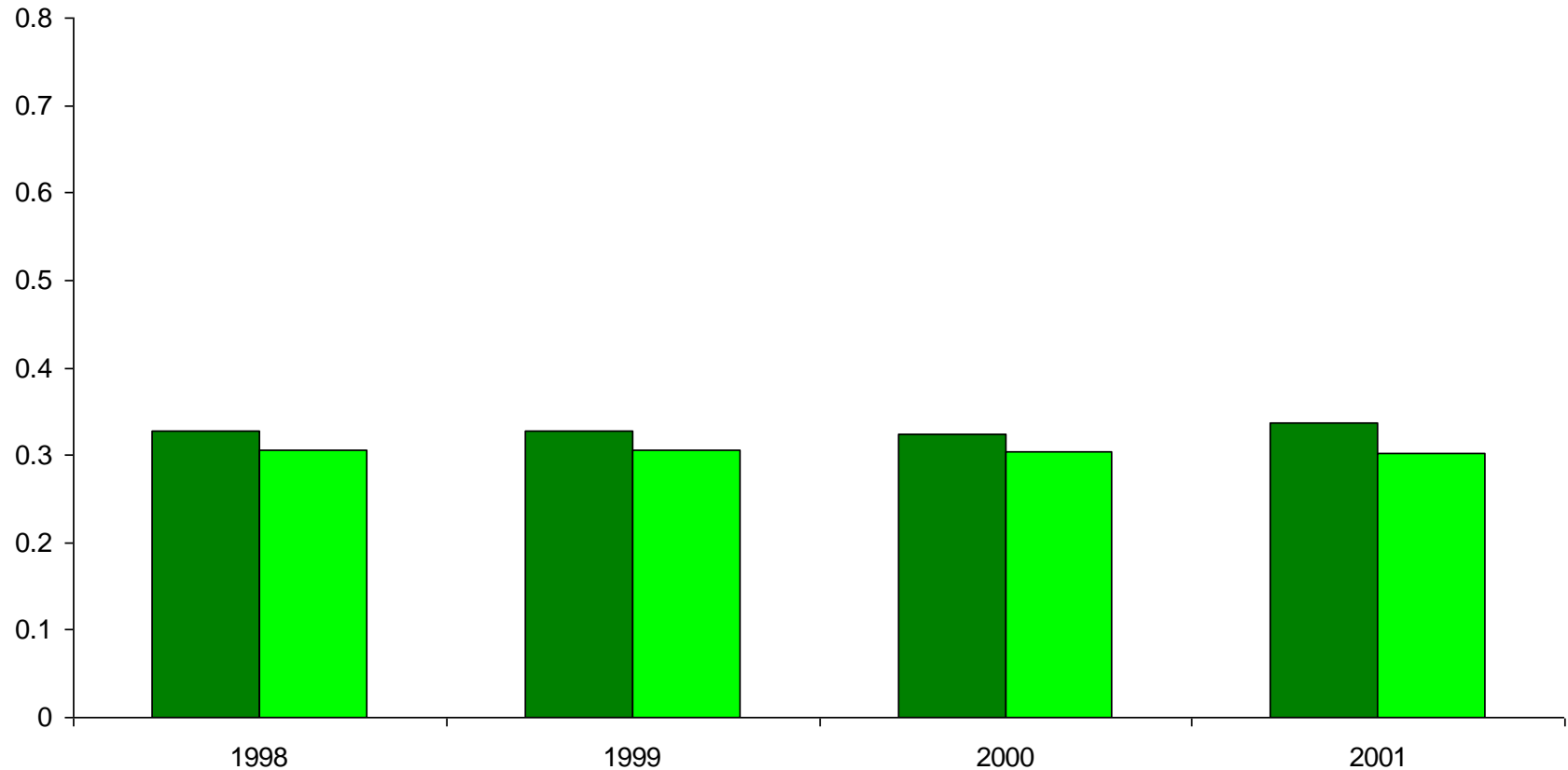
- But there seems to be clear selection or sorting effects.
 - MNEs have are more intensive in non-routine and interactive tasks than non-MNEs.

Employment share of non-routine tasks in German service firms 1998-2001



Source: "Offshoring and the Onshore Composition of Tasks and Skills" by Sascha O. Becker, Karolina Ekholm and Marc-Andreas Muendler

Employment share of interactive tasks in German service firms 1998-2001



Source: "Offshoring and the Changing Composition of Tasks and Skills" by Sascha O. Becker, Karolina Ekholm and Marc-Andreas Muendler

Conclusion

- Fast-growing component of trade that may be expected to continue to grow.
 - Scope for further improvements in IT/scope for further exploitation of the improvements that have been made so far.
 - Not much that trade policy can do to impede flows.
 - Although can make the in-house part harder by restricting FDI.
- “Big Deal” versus “Much Ado About Nothing” debate likely to continue.
 - But the latter view has so far received relatively more solid empirical evidence.