

Offshoring facts correct common myths

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Offshoring raises fears of jobs lost to low-wage economies. But the true extent of offshoring is notoriously difficult to measure.

Contrary to common belief, offshoring is not the preserve of large, developed economies, as the authors of "[Offshoring: Facts and Figures at the Country Level](#)" demonstrate in their review of offshoring in a range of countries, large and small. They also highlight the continuing prominence of manufacturing over the services sector; the latter, while on the rise, represents a small fraction of total offshoring.

The authors point out that offshoring, and its close relation outsourcing, is rooted in comparative advantages, an idea that has been around for some time. They hone their definition of "offshoring" to refer to the geographic location where the service or production process takes place, whereas "outsourcing" corresponds to the ownership of the means of production (in-house or third party).

Covering the period 1995-2000, they pose a number of questions. Are larger countries bigger offshorers? Do they show a significant tendency toward this practice? What is the importance of offshoring relative to economic sector? Are manufacturing industries more likely to go offshore than their service counterparts?

They conclude that smaller countries are, in relative terms, among the biggest offshorers and that, while the offshoring of service industries is growing faster than the offshoring of materials, the level remains insignificant.

Direct and indirect measures

The extent of offshoring can be measured either directly or indirectly, but the authors stress that direct measurement is almost impossible as it would involve devising a direct and comparable index for all industries.

Indirect sources need sifting and careful assessment. Consulting companies, for example, while they have continuous feedback with the private sector, are often found wanting in their methodology and scope. Company reports and press releases also need close examination: as offshoring has become synonymous with job losses, companies are often reluctant to publicize job shifts to foreign countries.

The other main sources are the indirect measures that could be drawn from official country records compiled by organizations such as the IMF and OECD. This is what the authors resort to in their work.

Smaller countries bigger offshorers

To rank countries, the authors use the OECD input-output tables as well as the IMF's assessment of the countries' nominal GDP. Three indices are used: imported inputs in total inputs, imported inputs in total output and a measure of vertical specialization.

Using these indices, the top 10 offshorers are almost all smaller economies. This is naturally so because larger economies produce a greater amount of inputs than smaller ones, thus curbing the relative extent to which the former are engaged in international trade.

Therefore, smaller countries such as Ireland, Hungary, Taiwan, Austria and Portugal rely more on offshoring as a form of international trade, in relative values. The largest economies - the United States, Japan, China, India and Brazil - perform at the bottom, while in the middle we find Italy and the United Kingdom.

For reasons the authors have yet to discover, Spain, Canada and Germany fall outside the pattern. The explanation ventured is that each borders on a vast and open market in the form of North Africa (and, for cultural reasons, Latin America), the United States and Eastern Europe.

A similar pattern emerges in the analysis of offshoring in terms of economic sector. Not only is materials offshoring far larger than services, but the larger countries offshore services far less than smaller ones such as Ireland, Luxembourg, Slovakia and the Czech Republic.

However, as better and faster communications emerge, any job that can be "put through a wire" could be offshored overnight, and the offshoring of the services sector may thus undergo rapid growth.

Misconceptions revealed

The authors conclude that, while offshoring is a hot topic, the debate is ill-informed and that, in fact, there is no real consensus on what the numbers mean.

Their empirical analysis sheds some light on widely held preconceptions. First, offshoring is not about large and highly developed economies relocating jobs in far-off countries but, on the contrary, smaller countries are among the most intensive offshorers.

Second, although offshoring in the services sector has grown, it doesn't appear, proportionally, to have gained much terrain.

They add a note on preferences in the use of indices, with broad measures performing better than narrow ones. And they recommend the use of either the imported inputs in total inputs, or the imported inputs in outputs indices. These provide a closer approximation of the true nature of offshoring on highly aggregate data, they say.

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