Discussion of "Threatening to Offshore in a Search Model of the Labor Market" by D.M. Arseneau and S. Leduc

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Overview of paper: Threat of offshoring and wages

- Labor search model of offshoring
- Evaluate
  - the effect of the *threat* of offshoring on global *wages* and labor market allocations
  - the effect of the *threat* on the responsiveness of *wages* to shocks
- Short run and long run analysis
- Contribution: analysis of *threat* on wages
- Literature: Baldwin (2006), Blinder (2006), Feenstra...
  Mitra & Ranjan (2010), Felbermayr et al. (2010)...

Overview of paper: The model

- Two-country labor search model (Mitra & Ranjan 2010, Felbermayr et al. 2010, Fahr & Vanhala 2010)
  - Multinational firm in home country: operates domestic and foreign plants, can shift production
  - Foreign firms produce only locally (domestically)
- Labor market frictions and bargaining - threat of offshoring matters for wages and allocations
- Model innovations
  - entry cost (Fujita & Ramey 2007, Hornstein et al. 2007)
  - sequential matching problem (Lagos & Wright 2005)
  - (endogenous participation)
- Mechanism
  - positive value of unfilled vacancy
  - *firms outside option* altered by possibility to offshore
  - both firm and worker acknowledge this in wage bargaining

Overview of paper: Results

- Threat of offshoring generates downward pressure on wages in the source country (lowers wages by 7%)
- Responses of wages and unempoyment to transitory shocks are significantly dampened by threat of offshoring
- These effects occur mainly in the short run, muted in the long run when firm entry and capital stock are allowed to adjust freely

Comments

1. Modeling strategy
2. Connecting the domestic and foreign labor market
3. Wages and participation
4. Shocks
5. Quantitative analysis

Comments: Modelling strategy

- Appropriateness of search-matching model in offshoring
  - Lumpiness: jobs are not outsourced individually but rather in larger quantities
  - Do we need search frictions in the foreign market to derive the wage effects? Is an offshoring cost enough?
- How does outsourcing differ from buying intermediate inputs for the domestic labor market effects (which seem to be the main interest)?
- Is labor force participation a key margin for this issue?

Comments: Connecting the domestic and foreign labor markets

- Labor markets need to be connected for offshoring threat
  - Connection has to come through labor market or complementarity of inputs in production function (or both)
  - Conventional free-entry assumption ($V = 0$) does not allow for the interaction through labor market
- Author's choices
  - **Entry-cost** to make vacancies a state variable (Fujita & Ramey 2007)
  - **Sequential matching** for threat of offshoring
    - is sequencing necessary?
    - isn't it sufficient that firm can post vacancy in foreign market to obtain effect on wages?
    - in equilbrium value of domestic and foreign vacancy should be equal
    - domestic workers will acknowledge this threat when bargaining (... participation)
    - is it realistic that unfilled offshored vacancy is returned to domestic market (to be offshored again)?
  - **Complementarity of inputs** in production function?

Comments: Wages and participation

- When setting $\Omega = 0$ and entry cost $= 0$ one would 'normally' get the standard M-P wage equation

$$\hat{w}_{D,t} = \eta f_{n_D,t} + (1-\eta)\left[\frac{h'(lfp_t)}{u'(c_t)} + \underbrace{b + \beta_t\,(future\_value)}_{U_t}\right]$$

- **Endogenous participation margin**
  - Free entry of workers: $U_{D,t} = U^*_{D,t} = U^*_{D,t} = 0$
  - No future value for workers in wage derivation (ref. Hall/Milgrom 2008, Lechtaler, Snower et al. papers 2010, 2011)

$$\hat{w}_{D,t} = \eta f_{n_D,t} + (1-\eta)\frac{h'(lfp_t)}{u'(c_t)}$$

Comments: Shocks

- Permanent shocks - Baldwin's (2006) "Great Unbundlings"
  - Offshorability shock: viewed as technological change - lower cost
  - How about shock in foreign labor supply (eg. China)? (eg. Fahr & Vanhala 2010)
- Transitory shocks
  - Trade liberalization shock temporary, AR(1)?
    - slow moving long run phenomena, eg. WTO membership of China
    - instead: temporary shock to eg. shipping (transport) costs
    - or perhaps rise of protectionism (in the first years of the crisis)?

Comments: Quantitative analysis

- Focus is on U.S.-Mexico "Maquiladoras". How would the analysis change for eg. U.S.-China?
  - Effects of U.S. offshoring on Chinese economy is certainly smaller than what it is for Mexico
  - Germany and former Soviet-bloc countries?
- "Offshoring" parameters have wide range in the literature, sensitivity analysis important
  - Zlate (2010) U.S.-Mexico
  - estimates of offshorable jobs

Authors	Jobs concerned	Countries concerned	Percent of tot. empl.	Year
Jensen and Kletzer	9.4 million	United States	9.4%	2000
Garner	14 million	United States	10%	2000
Van Welsum	23 million	United States	18.1%	2002
Beedham and Kroll	15 million	United States	11.7%	2003
McKinsey Global Inst.	160 million	World-wide	11%	2003
Blinder	28-42 million	United States	20-25%	2004

Final remarks

- Very nice paper with a clear contribution
- Rightly focuses on *wages* and *threat* of offshoring
- Many potentially interesting extensions to the model
  - sectoral/task dimension
  - wage inequality
  - shocks