February 2018

Labor market effects of offshoring

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Offshoring effects on domestic employment are regularly part of discussions on international economic policy. Some argue that offshoring—that is, basing some of a company's activities overseas to take advantage of lower costs—reduces domestic employment, while others argue that it may have differing effects. Economists disagree because offshoring and employing domestically are choices made by individual firms and, therefore, a causal relation between the two is difficult to disentangle. However, according to the recent study "The labor market effects of offshoring by U.S. multinational firms: evidence from changes in global tax policies" (National Bureau of Economic Research Working Paper 23947, October 2017) by Brian K. Kovak, Lindsay Oldenski, and Nicholas Sly, offshore activity may have modest positive effects on domestic employment.

In an attempt to discover a possible relationship, the study identified declines in the cost of offshoring that result from new bilateral tax treaties allowing firms to avoid being taxed in two different jurisdictions. The authors looked at the timing of these treaties, incidences of double taxation, and pre-existing country mix of multinational firms to determine employment changes related to the treaties. Doing so allowed the researchers to evaluate the changes in employment within U.S. multinational firms, their foreign affiliates, and the broader labor market. The results of their research suggest that greater offshore activity increased net domestic employment, although reallocation of workers was substantial—that is, workers were moved to a different job within the same organization or workers may have been hired by other establishments.

The theoretical foundation for the study's panel difference-in-difference research design was the incomplete contracts model of multinational firms, developed in 2004 by Pol Antràs and Elhanan Helpman. The primary data source was the Survey of U.S. Direct Investment Abroad, conducted by the Bureau of Economic Analysis. The research shows that decreasing the effective tax rates on foreign affiliates through tax treaties increases employment at the domestic parent firm. This relationship suggests that scale effects (that is, lower costs leading to lower prices and increased output) may outweigh substitution effects (firms modifying their activity toward cheaper alternatives, such as firms opting for cheaper overseas labor). Employment declines in establishments are offset by expanded employment in other establishments, yielding a modest positive net effect.

The study provides estimates that rely on relevant and exogenous variation in offshoring costs. These estimates assist the researchers in inferring causal effects on offshore employment for the U.S. labor market. The study highlights nuances in the effects of economic activities. These effects show that offshoring differs by organizational structures. When offshoring costs fall, some firms reallocate, which can adversely affect employment for U.S. workers. However, the positive effects may offset the negative effects. The results show a net positive effect on U.S. hiring when offshoring costs fall.