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HOW REMOTE IS THE OFFSHORING THREAT?

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NON-TECHNICAL SUMMARY

The offshoring debate in rich countries is perhaps as fierce as it ever was, but the focus concerning the origin and shape of what is identified by many as a major threat to high income countries has somehow shifted in recent years. Until recently the fear was heavily concentrated on the emergence of China and its depressing impact on the manufacturing base and the unskilled workers' wages in industrialized countries. The terms of the debate have now largely shifted toward the new competition of India on higher skilled jobs in the business services industry. In either case, workers in high-wage countries are concerned about maintaining living standards in the face of competition with foreigners who are willing to work for much lower wages.

Imports of services from low-wage nations merit special attention for three main reasons. First, the service sector employs about three times as many workers as the goods-producing industries. Second, the service sector contains a relatively large share of highly educated workers. These two facts imply a widening range of workers potentially facing competition from their counterparts in poor countries. The third special feature of services is that recent technological progress has been much more revolutionary with respect to moving ideas than it has with respect to moving objects. Since many services involve idea transmission, improved communication technologies can —in principle— place third-world service providers in direct competition with service workers in the developed world.

Does it mean that distance, which we know from previous work to be reducing trade in goods, has no impact on trade in services? It is the message largely conveyed by analysts like Thomas Friedman (using his famous "The world is flat" short-cut to the idea). To investigate this issue, we model the "international market for services" and generate a gravity-like model of service trade. We posit that physical distance, differences in time zones, languages, and legal systems, all raise the costs of employing foreign service workers. These costs may vary across service sectors and may change over time. We estimate the model using data for several categories of tradable services, and 64 countries over the period 1992–2004. Distance effects for the categories that include offshoreable services are statistically and economically significant throughout the sample period. In calculations based on plausible parameter values, service purchasers are willing to pay almost five times more for nearby (≈100km) than for remote

(≈10,000km) service providers. However, distance effects for most services have been declining in recent years. In 1992, the impact of distance is much larger for trade in services than for trade in goods, but the two effects converge to be now almost identical. If these trends continue, local service workers will increasingly find themselves in closer competition with foreign suppliers.

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