

## Chapter 5

### POLICY RESPONSES

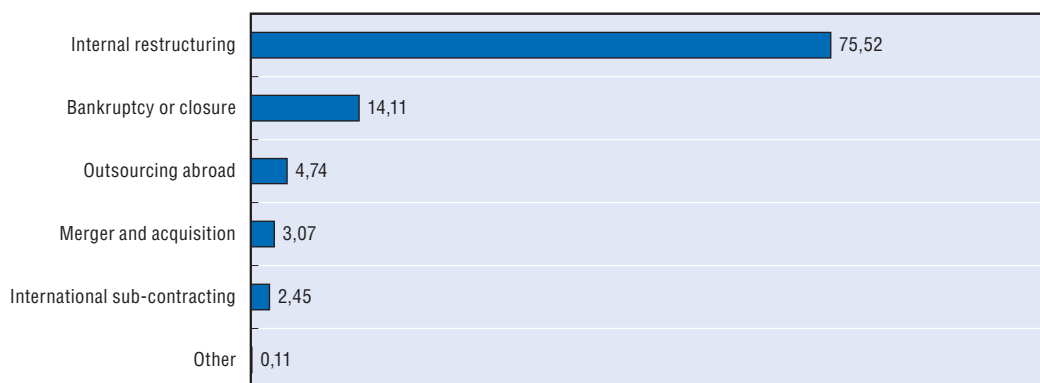
This chapter outlines how OECD countries are addressing the phenomenon of offshoring, be it via existing or new regulations and policy measures. Some measures to be taken into consideration in order to facilitate adjustments to offshoring are presented at the end of the chapter.

#### 5.1. Causes for concern

Studies carried out thus far show that job losses due to offshoring account for only a very low percentage of the total number of jobs destroyed. According to the European Monitoring Centre on Change (EMCC) in Dublin, relocate abroad is responsible for less than 5% of total labour shedding in Europe, far behind bankruptcies, closures and restructurings. Under these conditions, it might seem puzzling that relocation abroad has triggered so many debates and heightened such concern in so many countries.

**Figure 48. Jobs losses in Europe**

Industry and services, from 1 January 2002 to 15 July 2004, in %



Source: EMMC/Dublin.

A number of factors could explain these concerns:

- *Underestimation of the impact.* Firstly, in the absence of official surveys and due to the complexity of the offshoring phenomenon, it is highly likely that the results of studies underestimate the true impact of offshoring. In chapter 3, as well as in Box 12, we saw how the many indirect effects were never measured, while for the direct effects only partial and indirect measurements are taken into account. . Therefore, a part of the restructuring of multinationals has relocating implications as many activities are scaled back or eliminated in a country while being strengthened in others. At the same time, the bankruptcies or closure of factories could well be indirectly linked to offshoring, if the businesses in question have failed to move offshore certain activities when they ought to have done so and were unable to stay competitive as a result.
- *Chronic high unemployment.* The reactions of those who lose their jobs as the result of offshoring might differ if in their own countries unemployment were at tolerable levels and if the average time-scale for finding a new job were lower. In such cases offshoring is not a major problem because those who lose their jobs can easily find another in a relatively short space of time.
- *Regional and sectoral impact.* Offshoring can have a more important impact on certain regions, notably when the activities that have been wiped out were at the heart of the economic life of the regions. Even so, some sectors are more affected than others, and it is this aspect that makes the effects of offshoring so conspicuous.
- *The attractiveness of new emerging countries.* The emergence of new countries that are large in size, that have manpower that is not very costly and which is becoming increasingly skilled (for example, China, India, Brazil, Russia etc.) in the context of a new division of labour and world competition, creates a sense of insecurity. If sectors that are relatively protected, such as the computer sector, are insufficiently sheltered from international competition, this will heighten the concern of skilled individuals who may lose their jobs, but also unskilled individuals whose jobs become even more vulnerable.
- *Mismatch between the costs and benefits of offshoring.* While job losses due to offshoring are immediately known and visible, the benefits which companies derive from offshoring only appear after a certain period of time. The improvement of competitiveness of these businesses and the possibility of investing in new technologies and thus creating more skilled jobs has never been the focus of surveys regarding the firsthand consequences of offshoring. On the one hand, the difficulty involved in such assessments and, on the other hand, the delay in the creation of new jobs means that the public fails to draw any connection between the two phenomena. Increasingly, the benefits derived from offshoring are rarely announced in the media and most of the time the new jobs demand new skills and are not necessarily intended for those individuals who lost their jobs due to offshoring.

**Box 12. Offshoring that has an indirect impact difficult to assess**

- A business trims its workforce by outsourcing certain operations to other domestic firms. Those other firms in turn subcontract operations to other companies abroad.
- When a firm offshores operations that generated exports and its exports are then carried out by offshore affiliates, other domestic firms that do not move operations abroad and that export to the same markets may trim their workforce because they are no longer competitive enough to export to those markets.
- A business will be prompted to cut its staff when its main competitors have moved operations offshore and sell goods and services in the domestic market at more-competitive prices.
- A business may replace a domestic subcontractor with a subcontractor abroad. The job losses relate to the subcontractor alone, who is not responsible for the decision.
- Businesses that receive government subsidies or contracts use many domestic subcontractors, some of whom make use of second- or third-degree subcontractors abroad.

## 5.2. The reaction of public authorities: what must be avoided

To gauge political reactions when faced by offshoring, the Secretariat has distributed a brief questionnaire to member countries for which the results will be presented in Annex 5.

Faced with the concerns which have sometimes appeared to be exaggerated and which are often divorced from reality, some politicians and local officials are tempted to propose measures intended to hamper or penalise firms that move operations offshore. But these proposed measures could be counterproductive in the long term (see Section 5.3) and often in contradiction with countries' international engagement. This could probably explain why, to date, no country has taken coercive measures vis-à-vis offshoring.

The most frequently proposed measures are:

### ***Cancelling or requiring repayment of government aid to firms that shift operations offshore***

At the present time, some countries make certain types of government assistance subject to certain conditions, including a pledge to maintain employment, especially on a regional level. In such cases it is only right that companies that accept this conditional aid should comply with its rules of attribution. In contrast, if the aid were granted unconditionally, it would be illegal to ask firms that shift operations abroad to refund it.

### ***Excluding firms that shift operations offshore from government contracts***

And a policy of making firms that shift operations offshore ineligible for government contracts would conflict with the aim of limiting budget deficits by reining in on public spending. As more and more companies shifted operations offshore, the central government would have fewer suppliers from which to choose. Moreover, such a provision would run counter to the laws of competition and the country's international commitments.

### ***Preventing trademarks from being moved offshore***

The issue of a ban on the offshoring of trademarks warrants certain explanations. First, a trademark is a sign that a company uses to distinguish its products and services from those of other firms. It gives its owner the right to prevent third parties from using the brand. Like patents, trademarks are registered with national or regional registry offices. Within the European Union, for example, it is the Office for Harmonization in the Internal Market (OHIM), located in Spain, that is the public authority in charge of procedures for registering trademarks.

The owner of a trademark is free to choose the country or countries that can produce the products that will bear that trademark. No national legislation can prohibit the owner from making that choice. The owner's only obligation is to indicate the country of manufacture if such notification is compulsory. Procedures for indicating the country of manufacture are already well regulated at the international level.

### ***Taxing the offshoring-related imports of companies that fail to comply with environmental rules***

The proposal to tax offshoring-related imports of firms that fail to comply with environmental rules raises a number of questions. It is true that in some countries multinational firms finding themselves subject to stiff environmental legislation decide to shift some of their activities to countries whose environmental legislation is lax or in some cases non-existent. The aim of taxing these firms' imports from countries that are non-compliant with environmental rules would be to force the firms to tailor their production systems to the country of origin rather than to move their activities offshore. But such taxes would be in violation of WTO rules.

#### **Box 13. Offshoring within the European Union**

In principle, offshoring within a unified market should not raise particular problems. In the case of the European market the main objection involves the fact that some countries use low corporate tax rates to convince a great many companies to move their operations there (see Table 5).

At the beginning of this report, it was seen that the two main reasons why businesses shift operations abroad were to cut costs and be closer to customers (Figure 3). On the other hand, tax considerations were paramount for parent companies, corporate headquarters or centres of decision-making (Figure 5).

Many examples confirm the low importance attached to corporate taxation with regard to offshoring of production. Some companies which had set up their activities in Ireland in the 90s prefer later to relocate to Eastern Europe, even though the corporate tax rate was higher than in Ireland which remained unchanged at 12.5% – the lowest in Europe. In contrast, in Eastern Europe wages are still several times lower than those of Ireland.

### 5.3. The cost of not moving offshore

Here the main question is to ascertain the cost to firms, consumers and national economies if businesses, for a variety of reasons, were unable to relocate or were prevented from relocating their operations abroad.

If governments were to take some of the above measures so as to limit or hamper offshoring, it could have a significant administrative cost. The State should thus be in a position to assess the state of competition regarding each product and service of firms that move operations offshore, and should take a position on the extent of immediate or future risk run by the firms so as to ascertain whether offshoring is justified or not. Such costly assessments, which to date no country has attempted, might be more difficult to carry out, given the complexity involved in detecting the multiple indirect effects of offshoring.

While to quantify them would be an extremely difficult undertaking, the main costs of not shifting operations offshore could be summarised briefly as follows:

- In the most unfavourable instances, plants could be shut down entirely. This would entail far more job losses than initially expected.
- If offshoring can preserve other jobs at home, then not offshoring cannot save them.
- Not offshoring prevents firms from consolidating their financial positions and restoring competitiveness. In such cases, firms will lack the resources they need to invest, upgrade products and services, innovate, adopt new technologies or create new, and in many cases more highly skilled, jobs.
- Consumers are denied the benefit of more-competitive prices and suffer a decline in their income.
- The fall-off in business due to impaired corporate competitiveness may trigger more job losses than layoffs as a result of offshoring.
- The central government cannot use the resulting lost tax revenue to assist workers who lose their jobs.
- More generally, the country cannot reap the benefits of offshoring mentioned in Sections 2.4 and 4.7.

The truth of the matter is that in an economy open to international competition, there is no effective way to prevent offshoring from taking place over the long term if a business considers it vital. Apart from the costs mentioned above, to raise obstacles can have other detrimental consequences in the medium term:

- In order to avoid labour unrest or penalties, some businesses may move even faster to relocate many of its operations abroad once and for all.
- From this standpoint, many companies prefer to do all of their job creation abroad.
- Domestic businesses are weakened by a loss of competitiveness and become more vulnerable to hostile take-overs by foreign firms.

It should also be stressed that to be concerned only with the number of jobs moved offshore, without looking at the types of jobs involved, is to take a highly short-term perspective. To want to save certain jobs at all costs, via government subsidies or coercive measures, when in the context of international competition those jobs will never be competitive, could constitute improper use of public funds. In contrast, it is important to help the people involved to train for other, more highly skilled jobs and to enhance the country's attractiveness in order to promote innovation and high value added, higher-range activities, especially in services and high-tech industries.

#### 5.4. Facilitate adjustments

Before exploring certain ways to facilitate adjustment, it would be necessary to recognise that: for many businesses, offshoring could be a vital step to take. Businesses operate in an extremely competitive economic environment which is changing fast. To remain competitive, they are compelled to adjust continuously to market conditions. For many firms, moving operations abroad is just one of many ways to adjust. For some, it could be vital to their survival, whereas for others it may be another means of preserving their competitive position. The costs of failure to offshore could be substantially greater than the costs of offshoring. It would be useful not to lose sight of the fact that offshoring is a fact of business life, and that it would be counterproductive to erect obstacles that would stand in the way of such efforts. Protectionism is wholly inappropriate, even as a short-term response to the problem of offshoring.

In this respect, offshoring adjustment is not necessarily different from the other types of structural adjustment. The main policy challenges appear, however, to be the same – regardless of the ultimate source of structural change: *i*) to create the general conditions in order to facilitate a smooth transfer of resources from declining to expanding activities; while *ii*) providing adequate assistance to those who experience adjustment costs as a result of structural change.

The policy challenge is therefore to facilitate reallocation so as to take advantage of new possibilities, while at the same time limiting adjustment costs for individuals, communities and society as a whole. By this standard, successful countries would not necessarily be characterised by stable sector patterns of production and employment or by the presence of particular industries. Instead, they would be characterised by their capacity to manage structural changes without experiencing long-lasting increase in unemployment and/or inactivity rates among working-age persons, while at the same time improving living standards as resources move into new and expanding areas. Successful countries would also ensure that the resulting gains in overall living standards are not achieved at an unacceptably high cost to adversely affected workers and community.

A number of policies may impact on the capacity of countries to adjust in the face of structural shocks. Reintegrating displaced workers is particularly challenging and involves policies to ensure sufficient work and hiring incentives, as well as employability. In addition, regulations and related policies should favour a mobile labour force and a business environment supportive of growth and job creation. In some cases, targeted policies are useful for assisting displaced workers to re-integrate into employment. However, the overriding advice to countries is to aim for good general policies to handle structural adjustments.

Measures that could facilitate structural adjustment include:

### ***Organise continuous lifelong staffing training at the national and local levels***

Various studies show that the most highly educated and best-trained people tend to keep their jobs, or that if they lose their jobs they will be able to find other ones readily. This is more evident when microdata (at the firm level) are used. *OECD Employment Outlook*<sup>2</sup> provides direct evidence that workers receiving training are both less likely to be laid-off and recover more rapidly in the event that they do lose their jobs. The OECD publication “*Promoting Adult Learning*” provides a wealth of material about how governments encourage the provision of cost-effective training to the adult force. The educational system must also factor in the new needs of a knowledge economy. It cannot restrict itself to conveying knowledge but must develop the abilities students need to acquire new knowledge and assimilate it rapidly throughout their entire careers. What is needed is to cultivate a desire to learn, to be creative and at the same time to have independent critical faculties and to want to take risks. If teachers are to take on such a role, their profession will have to be upgraded. The organisation of lifelong training for business personnel is one of the key issues in the quest to reduce unemployment and restore public confidence. This requires close co-operation between governments, including local authorities, social partners and businesses.

### ***Use social policy to help those individuals who lose their employment due to offshoring***

The use of social policy could be justified for those individual who have lost their employment due to offshoring and who have difficulty in finding other employment.<sup>3</sup> It is necessary to have a good overall employment policy framework in place which reinforces the structural adjustment capacity of labour markets and fosters high employment. Two other elements could play an important role in the co-ordinated policies: propose an adequate income support and a direct re-employment assistance to workers (e.g. job search assistance and selective training). The adjustment costs can be higher for workers who are elderly, have limited skills and are working in the manufacturing rather than the service sector.

Except measures mentioned above, an economic framework that favours business creation, other measures could also be taken into consideration in order to increase the adjustment capacity of the economies affected by offshoring.

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2. *OECD Employment Outlook 2004*, Chapter 4.

3. An excellent analysis of these problems can be found in Chapter 1 of the *OECD Employment Outlook 2005*, entitled “Trade Adjustment Costs in OECD Labour Markets”.

### ***Invite multinational firms to comply with labour standards and discuss their offshoring plans with employees***

Good management by multinational enterprises of employment and industrial relations can make an important contribution to addressing concerns about relocation abroad. Public policies to promote responsible business conduct are identified in the *OECD Policy Framework for Investment* and include effective enforcement of labour and other relevant laws, clear communication on expected business conduct to enterprises, supporting private sector initiatives for corporate responsibility, and active participation in international instruments such as the *ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policies* and the *OECD Guidelines for Multinational Enterprises*.

The OECD Guidelines are detailed recommendations to multinational enterprises by 39 adhering governments in all major areas of business ethics. In the area of employment and industrial relation, they cover all internationally recognised core labour standards. They also provide that in particular in the case of the closure of an entity involving collective lay-offs or dismissals, enterprises should provide reasonable notice to representatives of their employees and co-operate with the employee representatives and appropriate governmental authorities so as to mitigate to the maximum extent practicable adverse effects, and that in the context of bona fide negotiations, enterprises should not threaten to transfer the whole or part of an operating unit from the country concerned in other countries in order to influence unfairly those negotiations. Adhering governments have established a unique mechanism to implement the Guidelines – the National Contact Points and the “specific instances” facility by which they offer their good offices to help the parties to resolve disputes and build trust.

### ***Expand research and development efforts and innovation***

In a context of a globalised economy and keen international competition, ongoing innovation alone can limit the need for offshoring. More particularly, technological innovation can lead to the development of new products and services and new manufacturing processes, but it entails a sustained research effort. It must enable the creation of centres of excellence and close co-operation between the public and private sectors and between industry and academia. Research is vital not just for developing new technologies, innovating and thus contributing to growth and new job creation, but also for making it possible to absorb and assimilate advanced technologies that are developed abroad.

To remain competitive, businesses need to master new technologies and focus on the production of goods and services that are high-end or high-value added. Activities with a strong technological content do not merely encompass the traditional high-tech sectors but also others, for high-tech niches are to be found in all sectors. The non-stop breakthroughs in these niche categories can create or maintain many jobs. But by the same token this calls for a major effort in terms of R&D and the ongoing training of personnel. This effort to promote top-of-the-line specialisation and a knowledge-based economy ought not to exclude the small and medium-sized companies that are less well-equipped to innovate or train their staffs.



### ***Make science and technology appealing once again***

In many OECD countries, one can observe a lack of interest on the part of young people for the engineering and scientific professions and, more generally, for the culture of technology. Look no further than India, which has more than 700 000 engineers, and where approximately 80 000 engineers are trained every year. The dearth of scientists and engineers can create serious problems for R&D and the technological innovation of companies. Such a situation can promote certain types of relocation toward countries where manpower is better trained and cheaper. In other cases, businesses will have no option but to rely on foreign scientists and engineers.

### ***Abolish barriers to trade and investment***

Job losses due to offshoring could be offset by the growth of exports intended for the countries where offshoring has occurred. A vertical specialisation between parent companies and subsidiaries can favour complementarities in their interactions. More particularly, in the case of emerging countries the steady increase in revenue creates a supplementary demand for imports which could be met by the countries that are the source of offshoring.

### ***Improve quantitative cost/benefit assessments of offshoring***

At the present time knowledge of the scale of the phenomenon of offshoring, and of its anticipated social costs and benefits, is still patchy and inadequate. A better grasp of the subject will not in itself restore confidence, but it will provide better guidance with regard to the policies to be followed and will ensure policy consistency both in the short and long terms.

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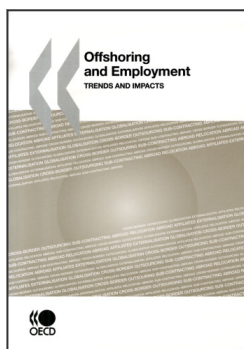
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