Columbia Center on Sustainable Investment
A JOINT CENTER OF COLUMBIA LAW SCHOOL AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues

No. 198 April 24, 2017

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How to handle the job-offshoring backlash?[*]

by

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Contrary to trade theory, emerging markets' comparative advantages in labor-intensive manufacturing are seldom exploitable immediately. They usually need support in such areas as financing, marketing and labor training. In this age of globalization, help comes from multinational enterprises (MNEs) that eagerly exploit existing and potential comparative advantages in search of low-cost locations for their supply chains. They can provide those missing elements in one package. They both supplement comparative advantages fully and amplify their strength through their superior capabilities. This makes low-wage manufactures even more competitive and reinforces an export-driven catch-up.

The flipside of all this, however, is that labor-intensive manufacturing of MNEs' home countries necessarily suffers even more job losses, further damaging the affected communities. Replaced capital is relatively footloose and reusable across borders (as MNEs' operations illustrate). However, replaced labor is not, due to a variety of mobility constraints. Undoubtedly, consumers benefit from low-cost imports—but unemployed consumers share little in this benefit. The faster the pace of MNE-assisted catch-up in emerging markets, the greater is the drawback for home-country workers and their communities. MNEs' low-wage-seeking drive helps maximize profits but diminishes social welfare in home countries—to an extent of stirring a political backlash.

Factory jobs, once the backbone of the US middle class, have decreased due to a shift largely to China and Mexico, mostly at the hands of MNEs. To be sure, automation has played a role as well, and will even more so in the future. But US factories are increasingly relying more on foreign robotics,[1] thereby missing an opportunity to create high-skilled jobs at home. Besides, robotics operators and related workers are in short supply in the US, calling for more focused skill-training. Europe, too, frets about job losses, as does Japan. Yet, job-offshoring damages the US most. As the world's richest, most open market, it is flooded with imports (many outsourced by MNEs) from emerging markets. Hoping that their catch-up would create new export markets, advanced economies have assisted emerging markets through aid and tolerated the ever-rising costs of trade adjustment.

MNEs' job-offshoring and employment of foreign high-tech workers are the easiest way-out to tackle high US wages and skilled-labor shortages. Other avenues include efficiency-raising strategies (e.g., cutting-edge robotics and skill retraining), but these take more time and efforts. Also, MNEs may retort that overregulation and high corporate taxes at home hamper these home-based solutions.

Resource-rich countries extract concessions from access-seeking MNEs. Similarly, catching-up economies (still semi-open) impose a slew of measures (e.g., joint ventures, tech-transfers, local procurement) on market-seeking MNEs. China uses its market most effectively in this regard. Analogously, advanced countries' rich markets should serve equally as a bargaining tool in trade negotiations.

Past European and US experiences suggest how to encourage job-onshoring. First, import tariffs induce "tariff-jumping factories." For instance, the European Common Market (benefitting insiders)—and later, the European Union (further disadvantaging outsiders)—lured MNEs' factories as new insiders in such an expansive market. The North American Free Trade Area likewise attracted investment. Second, diplomatically smart "voluntary export restraints"/"orderly marketing agreements" (characterized by "voluntarism" and devoid of retaliation-risk) have brought factories to both regions. Tariffs, attractive markets and voluntarism are three key job onshoring inducers.

President Trump's jawboning ("produce if you sell here, or else tariffs") is based on these inducers as a short-run expediency. His long-term growth strategy (tax-cuts, deregulation, infrastructure building), if successful, will make the US economy stronger, encouraging even more onshoring. In fact, his approach has already made MNEs "voluntarily" pledge more *new* jobs, though Martin Wolf argued that this "will not bring back [*old*] jobs."[2] Nevertheless, a better expedient (without tariff threats and retaliation) may be ad hoc compacts that make MNEs "voluntarily" restrain job-offshoring and/or expand domestic production under case-specific conditionalities. This gives more time for adjustment, and may be more congenial to MNEs (including fast market-capturing Chinese MNEs in advanced economies). Also, advocacy of corporate social responsibility helps home-country workers. For example, letting them train foreign workers before being themselves replaced by those same workers is unconscionable—unless new jobs are guaranteed. Given a growing shortage of skilled workers in the US, enterprises should be mandated to participate in developing a pool of skilled local workers.

Presently, trade-adjustment-assistance programs (skill-retraining, community revival) are the only long-lasting measures in the US and Europe. However, they have proved unsatisfactory—despite repeated tweaking over the past 50 years in the US—although Wolf still considered them "the best response." Exonerated from the social costs, MNEs may have been encouraged to offshore even more.

It is time to rethink how best to handle the job-offshoring backlash, now that multilateralism is declining and a new era of bilateral pacts, including between nationalistic states and globalist MNEs, is dawning.

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[1] "Driving U.S. factories: foreign robotics," *Wall Street Journal*, Mar. 27, 2017.

[2] "Tough talks will not bring back jobs," *Financial Times*, Jan. 31, 2017.

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