Trade Costs, Wage Rates, Technologies, and Offshore Outsourcing*

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Abstract

In a two-country model, we examine offshore outsourcing decisions by two domestic firms which are heterogeneous due to different marginal costs (MCs) of production. We specifically decompose the MC into the wage rate and the labor coefficient. Both lower foreign wage rate and lower trade costs make outsourcing more attractive, though they may generate different effects. When both firms use outsourcing, a decrease in the transport and communications costs improves domestic welfare. Surprisingly, however, an increase in the foreign wage rate as well as an increase in the domestic tariff rate may enhance domestic welfare.

Keywords: outsourcing; oligopoly; heterogeneous firms; trade costs; wage rates, technologies

JEL Classification: F12, F21, F23

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