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Tariffs, offshoring and unemployment in a two-country model*

by

Ken-ichi Hashimoto†

Abstract

We develop a two-country model of international trade that incorporates outsourcing opportunities, and we analyze the effects on employment and effective demand of outsourcing in the home country under stagnation when there is a liquidity trap. A rise in the tariff on imported outsourced goods causes production to shift from the foreign to the home country. This increases employment in the home country but also causes an appreciation of the real exchange rate, which reduces employment. The latter effect dominates the former, so that home-country employment and consumption fall. However, the home and foreign countries respond in opposite ways to the production shift caused by the tariff and to real exchange rate adjustment. Consequently, employment and consumption in the foreign country rise. Furthermore, when there is unemployment, the effects of outsourcing on consumption are opposite to when there is full employment.

Keywords: employment, real exchange rate adjustment, outsourcing, tariff

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† Graduate School of Economics, Kobe University, 2-1 Rokko-dai, Nada, Kobe 657-8501, JAPAN. E-mail: hashimoto@econ.kobe-u.ac.jp