Offshoring, globalization and welfare

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Abstract

We investigate the issue of offshoring in a model of two countries and one sector of increasing returns to scale. Firstly, our model uncovers that in a setting of footloose capital, offshoring volume evolves in an inverted U-pattern when transport costs decline. It can well explain China's offshoring soaring in the past decades as well as its decline recently due to rising labor and other factor costs. Secondly, we find empirical evidence by investigating offshoring between U.S. and China with three-digit industries data from U.S. input-output tables and international trade statistics for 1998-2010. Third, offshoring may hurt welfare in the low-wage country in the sense that rising wage ratio results from offshoring pressures capital and firms to flow out.

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