Chapter III

Global Sourcing:
East-West Divide
or Synthesis?

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Abstract

This chapter shows that ICTs make possible a more inclusive global trade, since now labour intensive components of production can be unbundled and sent where it is cheaper. The new mobility of virtual labour, together with the rise in capital mobility, will lead to a wider diffusion of benefits. ICTs reduce frictions and search costs in labour markets, and allow access to new hitherto excluded segments, whether firms or workers in developing countries or women. The smaller scale of efficient production induces more entry of new firms, thus raising wages and employment more than profits, and benefiting workers. Higher levels of employment and learning-by-doing can, in turn, induce more labour using technological progress and further raise both productivity and wages. Policy that targets education and training of workers and reduces barriers to the entry of new firms can minimize underinvestment and short-run job loss for developed country workers.

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Introduction

This chapter examines the benefits and costs of global sourcing and how they are distributed over workers and firms, over time and across countries, and the implications for social processes. Internet and communication technologies (ICT) which support global telecommunication networks, have the potential to decrease global inequalities, since technology now allows labour intensive components of production to be unbundled and sent where it is cheaper. But a selective focus on one or other aspect of benefits or costs, or ignoring the short-run nature of the costs compared to the widely diffused long-run gains, can place impediments on global sourcing thus reinforcing old divides and lowering potential benefits.

Since definitions are not yet settled and many words are used, we use the term global sourcing to cover offshoring or the relocation of business processes, which could be either production or services to a lower cost location, which maybe overseas, and outsourcing which is normally used for a third party service provider running a business process. Intermediate or component goods trade, which involves a horizontal splitting of the production process, has formed a major part of international trade in the '90s. Outsourcing of business processes or services is more recent and is affecting the welfare of millions as work migrates across the globe to find the lowest cost supplier.

The basic change that allows global sourcing is that ICTs reduce frictions and search costs for labour and allow market access to geographically separated entrants. Thus it is possible for a worker in one country to be employed in, or do some work for, a firm in another country. Entry costs fall also for new firms. If some component of production is offshored or a component acquired from another firm, ICTs facilitate the greater coordination required. If a service is contracted to a third party, ICTs make this outsourcing feasible, and the third party is part of the process that matches labour to a distant job.

Opportunities improve for one set of workers, but home workers face more competition. These emotive issues of livelihood and relative gains have led to a spate of recent studies. But the effect of easier matching of firms with labour, and the thickening of market opportunities in developing countries, has not received attention. Cost savings are driven by falling cost of coordination due to new technology, and the cumulative productivity increase from improved incentives for education and technology adoption. These will make wage increases in provider nations sustainable.

This perspective is particularly suited to analyze the marriage of ICT and different types of global sourcing and makes a number of contributions. First, it shows why freer trade will increase global equality. This was the conclusion of classical trade theory, but was reversed by new trade theory, and is now reinstated but with some modifications we explore.

Second, the implications of improved matching give lessons for business. These include the importance of investing in new technology and in worker training, both to take advantage of trends that are inevitable if the required policy support is forthcoming, and to contribute to these trends. There are also lessons for workers and policy makers. Technology, competition and education turn out to be the important factors. Under easier
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