Discussion comments on "Exploring international migration and outsourcing through an institutional lens"

Adrian Blundell-Wignall

Introduction

It is a privilege to be asked to comment on this paper in honour of my friend Palle Andersen. Palle was a gentle person and his interest in empirical research had a certain power that I believe came from his "detachment". He focused on data quality and thoroughness, and he never had those blinding priors for which empirical support is all too often too easy to find. I will miss him.

I found the paper by Professor Rubery and colleagues to be very interesting. It is refreshing to look at issues through the institutional lens and to challenge my own understanding of globalisation through outsourcing, offshoring and migration. The paper looks at three case studies: temporary staffing agencies; elderly care; and IT-related outsourcing/offshoring. The methodology used is to consider two-way causation issues between migration/offshoring and institutional forms through which growth takes place. The paper then assesses the impact on employment conditions and uses a qualitative cost-benefit assessment (based on an equity versus efficiency discussion) to lead to some policy conclusions. The focus of the paper is primarily on European countries and the resources used are data snapshots, research citations, anecdotes and a thorough knowledge of institutional forms.

The paper is convincing in illustrating how outcomes vary according to different governmental and organisational actors. The four policy conclusions are strong, and seem to lend more weight to equity rather than efficiency in comparing costs and benefits. These conclusions are:

1. That re-regulation may be needed, including for minimum wages, to maintain labour standards.
2. That offshoring and migration risk postponing much needed domestic retraining to meet skill shortages.
3. That organisations facilitating globalisation sometimes fly under the regulatory radar screen and codes of practice need enforcement.
4. That offshoring, etc may be encouraging a trend towards the short term in labour relations that may harm efficiency (better quality and safer strategies).

1. The long-cycle setting

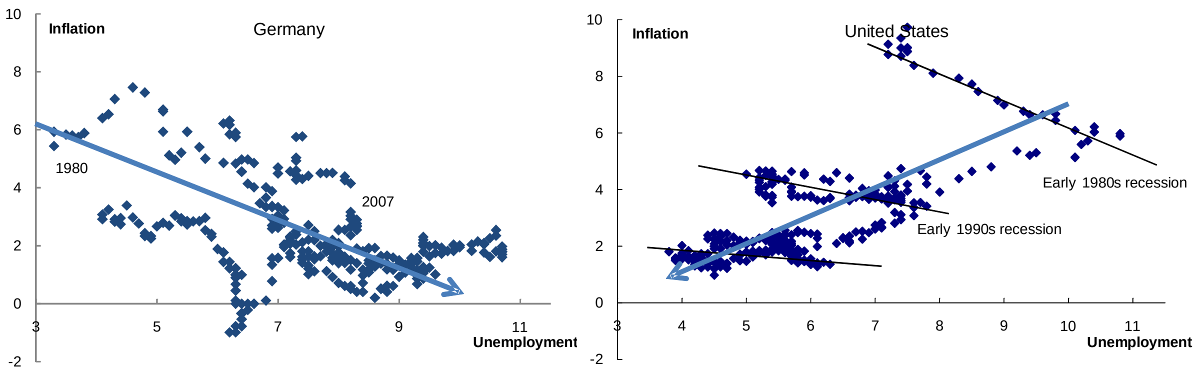
There is a methodological issue at the outset: the role of complex institutional forms (like regulation, culture, unions, form of economic system (liberal or coordinated), training and qualifications, role of agencies, outsourcing, etc) versus structural long-cycle trends (like migration, outsourcing, female participation, ageing, improving health and global industrialisation) all influence labour market outcomes and equity versus efficiency issues. There are many moving parts here, and inferences to be drawn about policy presumably need to take all factors into account while weighing what is important in any one area.

Aggregate outcomes such as the Phillips curve trade-off are all-inclusive – so my comments start there, and work backwards to the specific case studies. A look at the aggregate outcomes over the past three decades certainly makes the authors' point concerning the power of institutions to influence the economic adjustment path very well. Graph 1 shows the Phillips curve for Germany and the United States, and the arrows reflect the general time direction of the trade-off. In the "coordinated economy" there is a downward-sloping curve, and dynamics that see the trade-off deteriorating over time. In the liberal economy the reverse is the case. The institutional forms in Europe appear to have been very successful in ensuring the world is "not flat". The authors argue at one point that institutional forms in Europe should not be seen as "obstacles". But these differences are so marked they do suggest materially different impacts on efficiency.

Graph 1

Phillips curves over time

In per cent



Source: Datastream.

Even as reforms are still being developed within Europe to improve efficiency, a new set of secular pressures on a scale not seen since the industrial revolution in the West is only just beginning.[1] I refer of course to the massive global supply shock associated with integrating the BRIC economies and others into the global economy. China is undergoing an industrial revolution with an urbanisation process on a gigantic scale: some 350 million people (compared to 18 million Australians) will move from rural to urban areas by 2020, and even then the country's urbanisation level will still be significantly below that of the West. India is industrialising and will experience strong growth in working age population over the next 50 years. Market forces – factor price shifts and trade – will ensure that these massive global labour and production resources are utilised and, provided policy is supportive, living standards should rise in both the East and the West.

I suspect that while we do not, as the authors say, know how things will work out, social choice considerations with respect to pay, pensions and standards of work will be subject to these secular pressures too. The West is ageing, and this is bringing falling potential growth, rising health care costs, pension shortfalls and age care pressures. Newly industrialising

[1] Eichengreen points to this issue in his book on Europe in the postwar period: the coordinated capitalism approach, involving growth-orientated governments, bank financing of investment, unions holding wages back to permit investment, unions on boards, apprenticeships, etc worked well for catch-up convergence (mobilising capital to utilise existing licensed technologies), but much less well in the last 25 years, which have required a greater focus on increased efficiency and internally generated innovation.

countries are saving massively, driving down the global cost of capital, and educated labour outside of the West is cheaper. Western countries are currently able to borrow at the lower global cost of capital to invest in the restructuring and IT necessary to manage global supply chains while maintaining consumption. The use of offshoring and migration necessary to take advantage of relatively cheaper global labour pools is integral to this process. Joint ventures and foreign direct investment in emerging countries are equally important. These mechanisms are allowing the West to move out of activities producing lower value-added and up the value-added chain, thereby enhancing productivity.[2] Protectionism and regulation to resist these pressures are not supportive policies and would probably be very costly in both the East and the West over the longer run.

These dynamic forces mean the very idea of a company's "core competency" is going to be subject to change, as technology platforms shift and population dynamics and factor price changes come into play. Institutional forms may influence the adjustment path, but whether these serve to erect costly barriers or, alternatively, to influence the terms and conditions under which globalisation happens in a favourable way, remains an open question.

2. The case studies

In looking at the authors' three case studies, it is helpful to keep a broad supply and demand framework in mind when assessing equity versus efficiency conclusions; in particular:

- An excess demand situation at the pre-globalisation wage in a high-skill occupation: strong demand and tight supply with a demographic and institutional context of tough migration rules and the ability to police them (eg no land borders, etc); slow growth of working age population (ageing, birth rate, etc); a liberal domestic economy framework; multicultural social norms; low union power; and low monopoly practices in qualifications and regulations.

  Prediction: relaxing migration rules in selective skill shortage areas will help productivity and be accepted in the host country without prejudice to pay or conditions of work. Outsourcing/offshoring will be low.

- An inelastic demand for a low-skill/low social status occupation at the pre-globalisation wage: with weak migration rules (or ability to police migration); tight domestic supply due to demographic and status issues; a coordinated economy policy framework; more xenophobic social norms; high union power; and strong monopoly practices in qualifications and regulations.

  Predictions: migration will be perceived as undermining standards, taking jobs and/or reducing wages. Offshoring will rise if the work can be commoditised and exported. Black economy practices and flying under the radar of the law will rise where jobs cannot be taken offshore.

---

[2] See, for example, Mann (2004). Mann argues that global sourcing in the 1990s reduced the price of IT hardware, which led to increased IT investment and more jobs for IT workers, and that the same is now happening with software. The widespread use of IT has led to higher productivity for the US government. Mann argues that in the United States, IT jobs are moving up the skills ladder. She advocates policies to increase the skill level of current and future IT workers, provide a safety net for displaced workers, and open up international trade.

Temporary staffing agencies

The paper by Rubery et al notes the role of temporary staffing agencies (TSAs) in creating more flexible labour markets and facilitating mobility. While emphasising the need to be context-specific, the authors conclude that: "TSAs appear to have higher penetration rates where there are more opportunities to change the terms and conditions of employment. This provides some a priori evidence that employers are motivated to use TSAs to reduce labour cost not through smarter working but through reduced rewards for work. As such, the availability of cheap labour provided through TSAs may in some cases allow employers to postpone the search for higher productivity through modernising of technology and work systems". They also suggest that sometimes worker standards are even lowered, with agencies pushing legal limits. Without the benefits of productivity gains, the four policy conclusions reached by Rubery et al might be justified by these sorts of observations. The evidence presented, however, is not conclusive. Table 1 of the paper shows the TSA sector to be fairly small, while Table 2 and most of the text summarise institutional differences between four countries, including my own country Australia. This does not bring to the table convincing evidence for the efficiency versus equity conclusions. More quantitative survey data, including outcomes on conditions and pay, with the two above supply/demand contexts in mind, throw up alternative hypotheses.

Table 1

Temporary skilled migrants in Australia

Survey of temporary ("457 visa") migrant workers, 2003–04, in per cent

Mode of recruitment	Managers/ admin	Professionals	Associate professionals	Trades	Other	Total
Overseas office of company transfer	29	16	6	1	1	16
Direct approach to employer	24	28	32	36	36	29
Direct approach by employer	23	15	22	17	12	18
Employment agency	8	20	9	4	9	14
Family/friends	10	7	25	26	17	12
Newspaper/internet advertisement	5	13	6	13	19	11
Migration agent	0	1	1	0	0	1
Survey question on whether foreign workers receive the same treatment as locals						
(a) Work conditions						
Agree	69.1	71.1	50	73.3	61.1	67.4
Disagree	8.8	14.8	25	13.3	11.1	14.2
(b) Pay						
Agree	67.6	66.4	43.8	73.3	50.0	63.2
Disagree	8.8	14.8	15.6	13.3	33.3	14.6

Source: Khoo et al (2005).

Australia's mining-led boom, tied into the structural industrialisation in China, led to significant skill shortages in the "professionals" (eg engineers, IT workers, etc), "managers" and "trades" (eg electricians) categories. So-called "457 visas" were introduced in the early 2000s mainly to target these "hot" areas. Less skilled "associate professionals" and "other" workers (clerical, back office, etc) are more available locally. In the skilled group the jobs (eg minerals extraction) cannot be commoditised and taken offshore; in the less skilled occupations they can.

TSAs played a significant (20%) role in finding professionals (engineers, IT workers and accountants, for example) – consistent with Skilled Engineering being the biggest player shown in Table 2 of the Rubery et al paper. But even here the Australian study suggests that direct approaches by employees were dominant, and other alternative recruitment categories were significant too. For the "management", "trades", "associate professionals" and "other" categories, TSAs played a very small role. In an excess demand situation the market finds a way, with agencies apparently playing a partly residual rather than driving role – markets will not incur systematic transaction costs with a middle man unless other mechanisms cannot cope. Other aspects of the Australian survey showed that:

- A wide range of ethnic origins were involved in the migrant labour market;
- There was almost universal positive feedback on the visa scheme by participants, with 68.6% reported as being in the highest category of "very satisfied" with their experience, and 60% wanting to apply for permanency. So good was the experience that the government introduced the "Employer Nomination Scheme" permanent visas in 2005, allowing 457 visa workers to convert to permanent residents.
- On pay and conditions, the high excess demand occupations showed very positive responses, whereas the low-skilled occupations were noticeably less happy (see Table 1 above).

I suspect that controlling for supply and demand in different occupational skill levels would also be found in other countries – investment bankers in London versus child and elderly care workers, for example. The world may not be "flat", but it might look a lot flatter if the same skill excess demand panels are controlled for.

Future work on TSAs might look at:

- The skill/excess demand situations in which TSAs operate;
- The residual role of TSAs in buffering firms' labour requirements over the business cycle (this is consistent with equity prices in listed temporary manpower companies being strong leading indicators of the business cycle in the United States and Europe).

Elderly care

Elderly care is different to the issues discussed so far – it is in the health care sector, the demand for it is inelastic beyond a certain point, and sometimes it is an "at home" or "within the family" occupation. While the case study is short, it is intuitively convincing. Elderly care cannot easily be offshored in a scalable way. I suspect that it is less skilled work, and that it will not enhance national productivity, as compared with an occupation like my mining engineer above. But perhaps we need different yardsticks in this area – such as "well-being indexes" that take into account quality of life factors.

Bearing in mind future demands posed by the ageing population issue, the authors' discussion of budget constraints that, with less regulation, may provide supply agents (family, private or government) with an incentive to use lowest-cost sources without quality assurance is instructive. Furthermore, any attempt to regulate elderly care in a way that significantly increases costs, particularly to families and private providers, may lead to black market solutions. In the general health care area these policy issues are difficult to assess, and it may well be that greater public responsibility for quality assurance is warranted. Even liberal economies that focus on use of private providers need full public scrutiny and provider accountability. Further research in this area is to be strongly encouraged, and conclusions 1 and 3 of the Rubery et al paper may warrant further attention by politicians and regulators. This research would benefit from more direct evidence on quality problems, including: social "well-being indexes" for the elderly; illness rates; and "death by cause" (including suicide) rates across jurisdictions. Identifying how institutional forms, regulations and oversight can improve the cost-quality trade-off will become increasingly pressing as populations age.

Offshoring

Some literature references, and anecdotes from the United Kingdom, Germany and India, are the main tools in this short section on the use of IT outsourcing/offshoring and migrant labour in call centres. The section is very short and no data is provided. This is a pity, because this type of activity is at the very core of the earlier theme of globalisation and moving up the value-added chain in the West. Use of foreign labour pools also provides a coherent avenue of inquiry for coping with the future demographics of ageing.

While the mining engineer needed in Panawanica in Australia's north-west cannot be "offshored", call centres for financial institutions certainly can. The authors note that over the past couple of decades this activity has shifted from 100% in-house work to widespread outsourcing to places like India, the Philippines and Sri Lanka, resulting in profit gains. The extent of outsourcing depends on how commoditised the labour function can be made: ie the extent to which it can be replaced either by IT or by an off-site/offshore centre. Answering calls for high net worth private clients often remains in house, where value-adding skills are required ("client advisers"), while information concerning balances and errors, transfers, processing of loan applications, etc is easily outsourced. The authors are right to suggest that labour is not a commodity. But it is also the case that turnover rates are high when commoditised work is done in house, and fewer of these problems are encountered in the value-adding areas. Future research might look at turnover costs at alternative skill levels to help determine the point where outsourcing becomes sensible from everyone's point of view: the worker, the client and the company.

More work on offshoring, foreign direct investment and global joint ventures in manufacturing, health care, education and other service areas is also needed to assess efficiency versus equity issues. Australian clothing companies today have become a growth success story in a previously declining sector – companies like The Just Group and Billabong manufacture virtually all of their goods in China, and have turned themselves into IT-based supply chain management and service sector employers.

Offshoring is also moving into pharmaceuticals, and in the longer run will be a part of the solution to ageing and health care costs. As much as 20% of finished generic and over-the-counter drugs, and over 40% of the active ingredients for those made within the United States, already come from India and China. By 2020 the latter share is expected to rise to 80%. Technology is also moving into simple medical diagnosis, and education. To be sure there are going to be implications for quality and adjustment costs for current providers of these services. But that is why the focus needs to be on the terms and conditions under which globalisation proceeds rather than policies to arrest it.

3. Conclusion

To conclude I will reiterate a few key points. A thorough analysis of institutional forms is important for identifying adjustment costs and for allowing for quality and social choice issues to be taken into account as globalisation proceeds. The paper by Rubery et al is a good contribution to this debate. In terms of cost/benefit and equity versus efficiency, the issues should be discussed hand in hand with conventional economic analysis, and with some consideration of the longer-run secular trends now in play that will limit choices. While the policy conclusions in the paper appear to be a little strong at this point in the debate, the authors make an interesting contribution and raise the right questions.

References

Eichengreen, B (2006), *The European Economy Since 1945: Coordinated Capitalism and Beyond*, Princeton University Press.

Khoo, S-E, P McDonald and G Hugo (2005): *Temporary skilled migrants in Australia: employment circumstances and migration outcomes*, Aust Centre for Population Research, ANU & University of Adelaide.

Mann, C L (2004): "What Global Sourcing Means for US IT Workers and for the US Economy", *Virtual Machines* 2, 5, July/Aug.