

Comments on Outsourcing and Volatility

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Main contributions of the paper

- New interesting stylized fact: Outsourcing industries in Mexico are twice as volatile as corresponding ones in the US
- A rich model with following ingredients:
 - outsourcing, entry and fast reaction to shocks
 - US is specialized in the fixed cost activity and Mexico in the variable cost activity

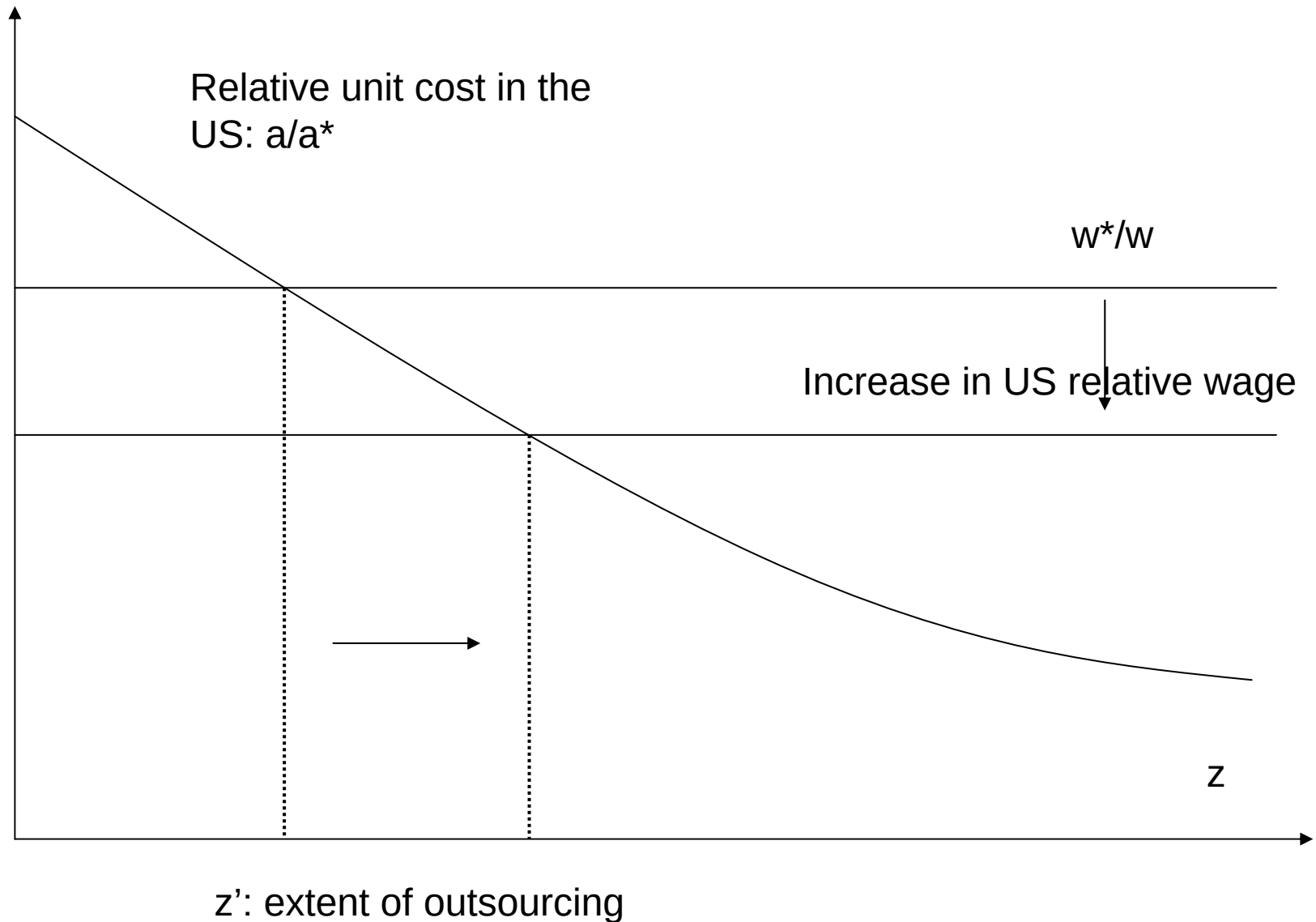
is able to replicate these broad facts

First paper to uncover this fact + first paper to have a model that analyzes the relation between outsourcing and volatility

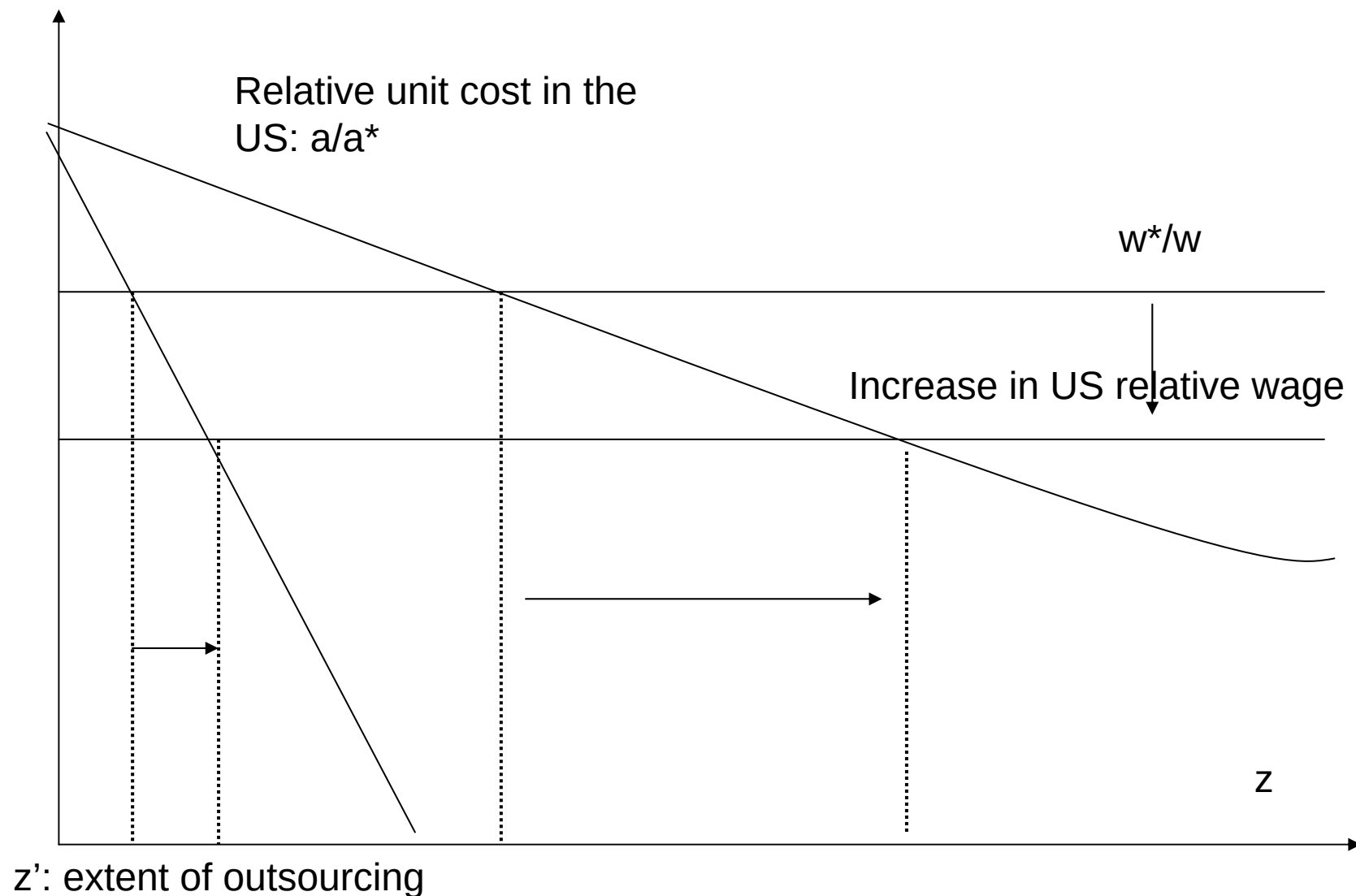
Basic intuition of model

- Boom in demand in US: relative wages increase and extent of outsourcing to Mexico increases
- Entry of new firms: increases production in US (fixed cost activity) but not so much because of counter-cyclical markups
- Mexico (specialized in the variable cost activity) has a large increase in production
- Mexico becomes more volatile than the US in this sector

The intuition for demand shocks



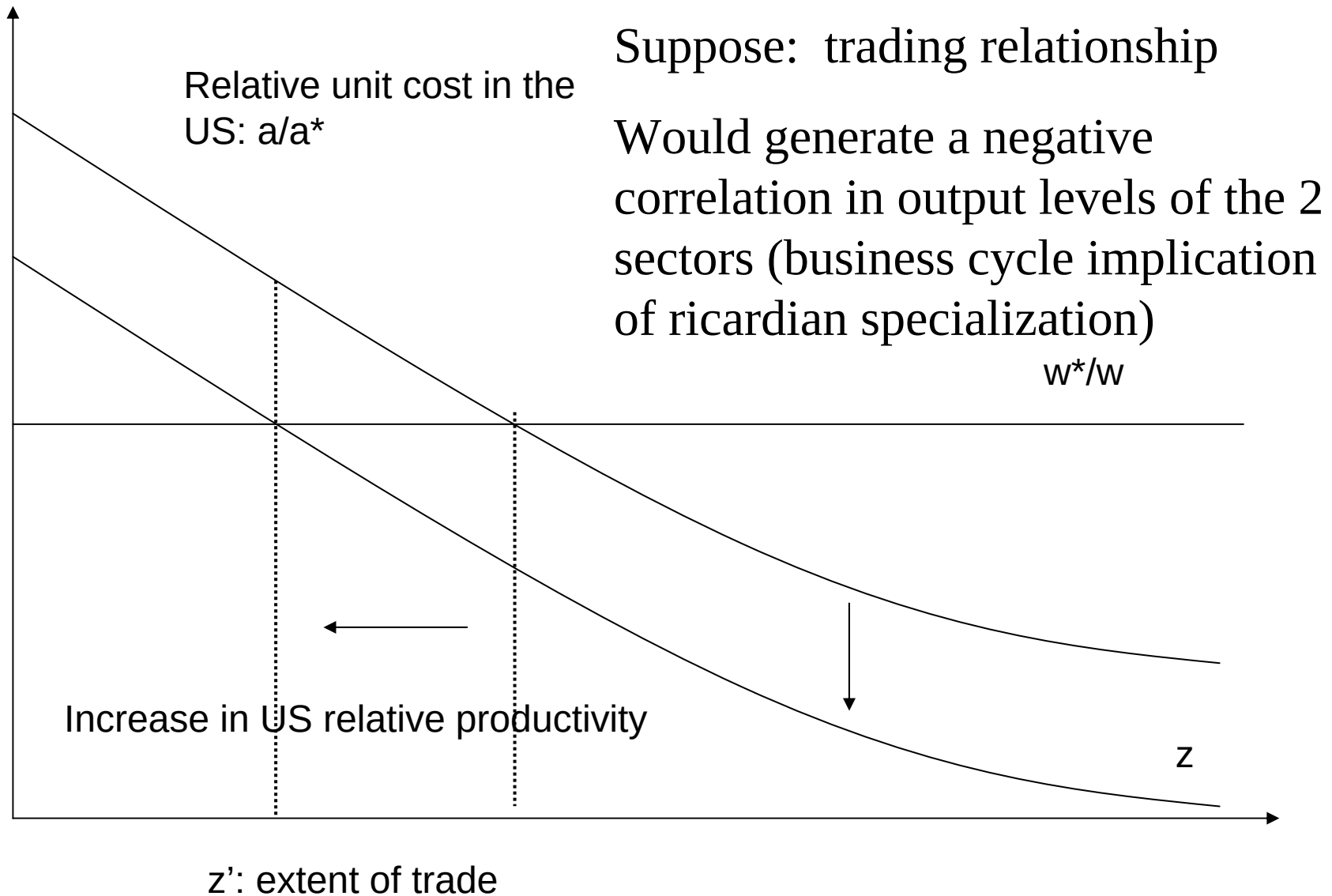
The amplification depends crucially on the slope of the distribution of relative unit costs in Mexico



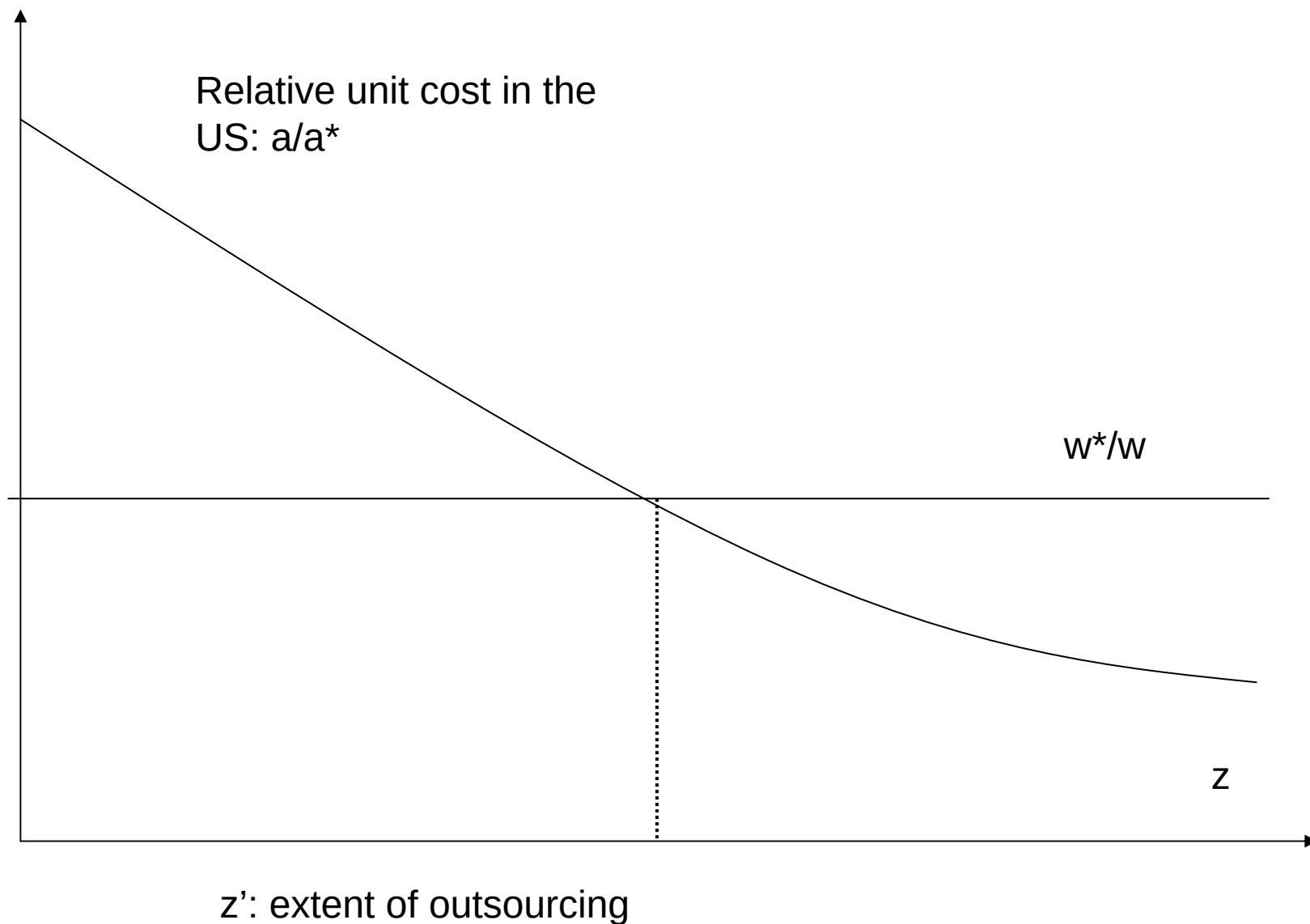
How important is this slope?

- A small slope (high degree of heterogeneity in firm/variety productivity) generates more entry and more amplification?
- But the firms that enter are less productive/smaller and have less weight in sector production?
- Choice of calibration for this slope is near zero (-0.001) : is there any way to get some empirical counterpart?
- Can a measure of firm heterogeneity in productivity be an empirical counterpart?

What is the difference between trade and outsourcing?
The way supply shocks affect relative productivity?



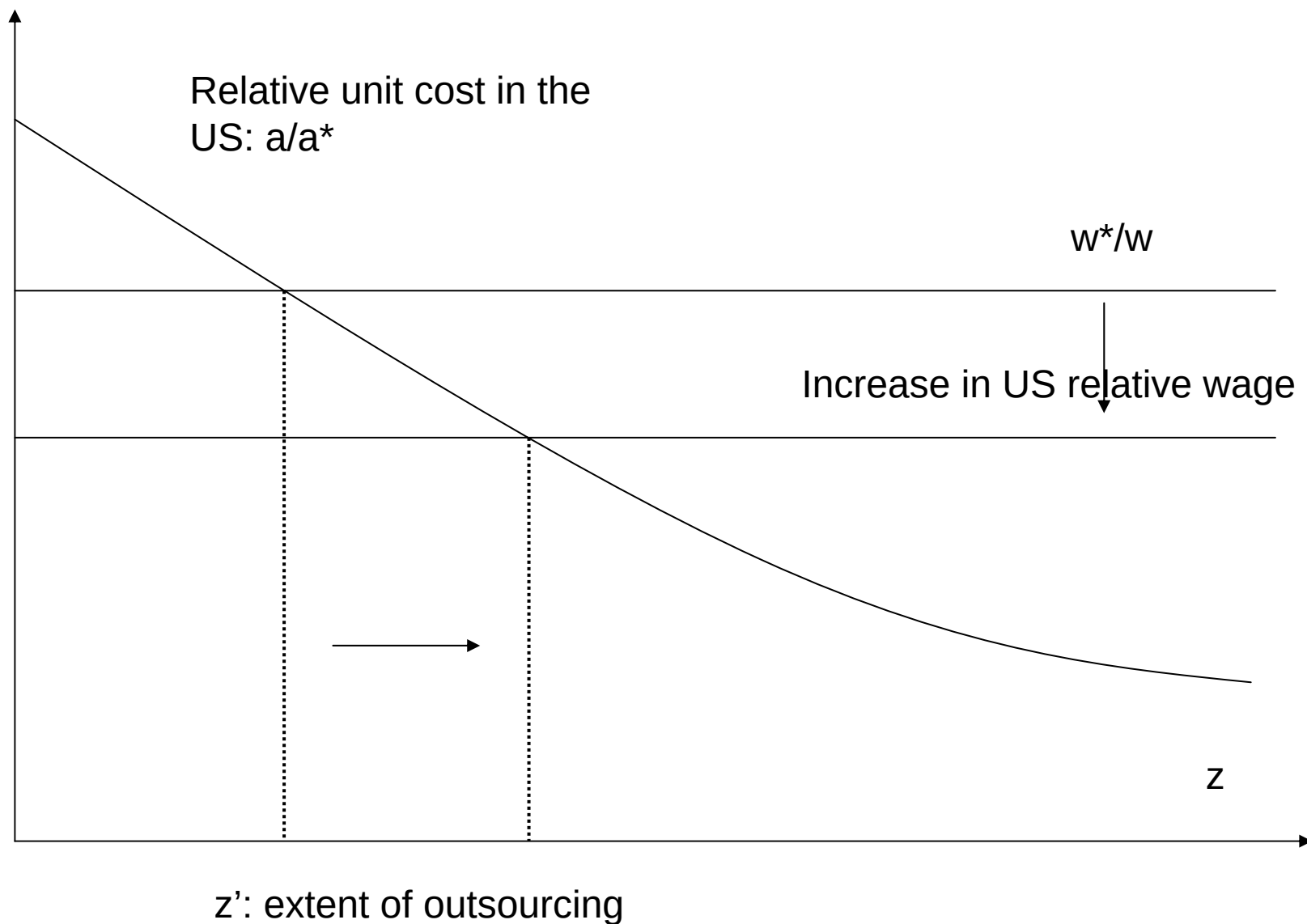
Here, supply shocks in multinational sector affect home + foreign counterpart in the same way. No change in extent of outsourcing



Interesting implication

- What is the justification and the consequence of this assumption (trade versus outsourcing?)
- Does this mean that outsourcing produces more volatility than trade?
- Seems to be the (subliminal) message of the paper
- Would be interesting to compare a model of standard trade and a model of outsourcing
- Important to clarify the difference between the two stories

Supply shocks in the non differentiated sector affect relative wages like demand shocks



Some remaining questions

- Would be useful to make the average share of outsourcing vary (even better to make it endogenous) : parameter $\bar{z}$
- How does volatility in the US and in Mexico change with extent of outsourcing?
- Here what happens to US volatility?
- What are the welfare implications? (here complete markets, so would only change if aggregate volatility changes with outsourcing)

What are the relevant demand shocks in the case of the US-Mexico relation?

- Government spending shocks may not be the most relevant demand shock
- Sector specific demand shocks: in apparel industry important to react very fast to fickle consumers
- But then suggests that Mexico's choice is not exogenous as a base for outsourcing for sectors with volatile demand : distance matters a lot because crucial to react rapidly to those demand shocks.
- This paper emphasizes impact of outsourcing on volatility
- Outsourcing (choice of country and activity to outsource) itself may be endogenous and be dependent on the level of volatility
- Is the US-Mexico specific in that matter? Not obvious that firms would outsource the same types of activities to China

Policy implications (questions)

- Is volatility exported and does this make monetary policy easier for country that outsources, harder for country that does the outsourcing?
- Is this happening in Europe with Eastern Europe?
- How does a single currency change this? If it helps outsourcing, it also makes monetary policy more difficult for these countries (candidate countries)