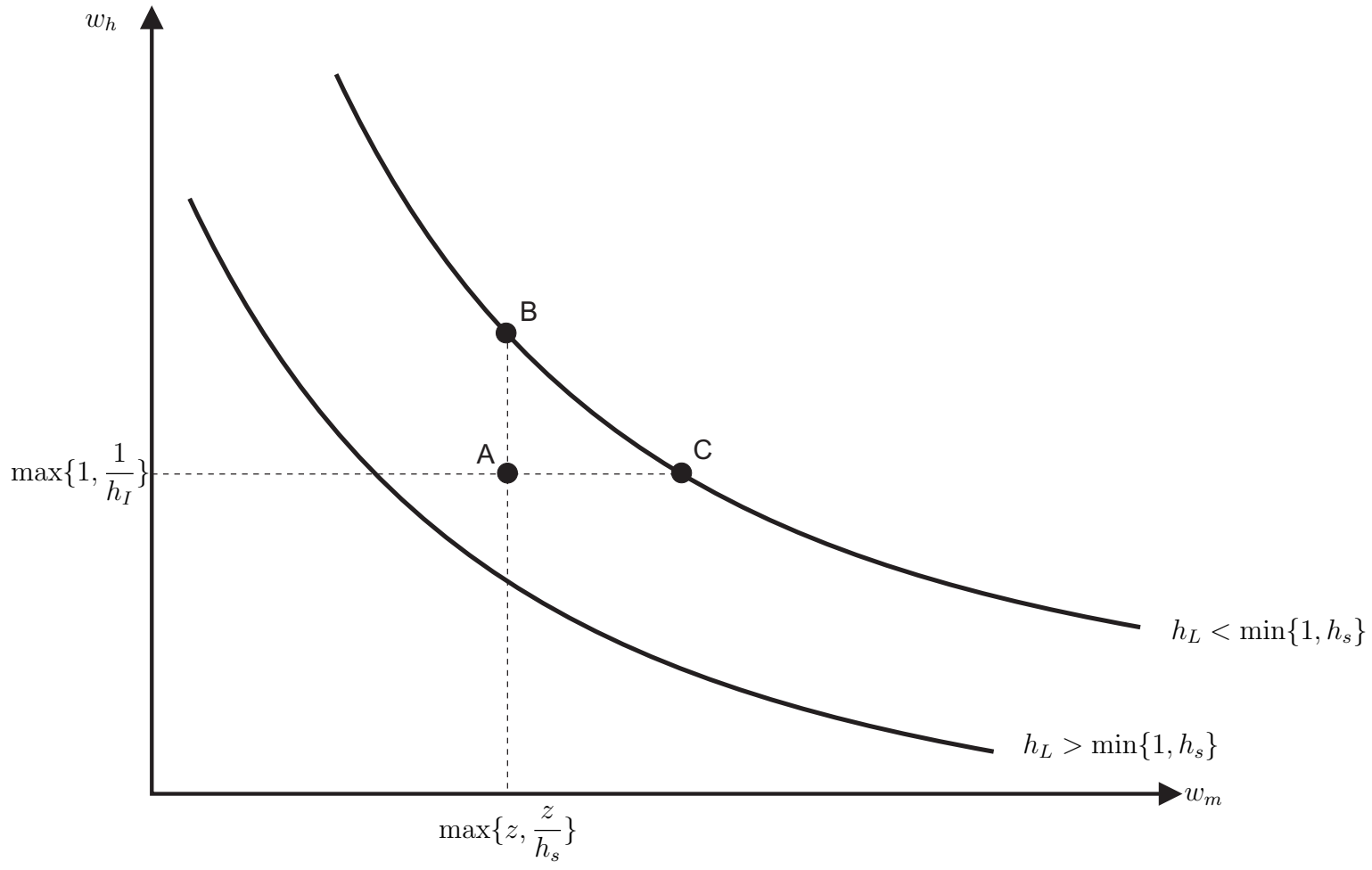


The Model

- Production requires solving problems, $z \in [0, 1]$. Output equals problems solved.
- The world contains three types: $s \in \{l, m, h\}$ with abilities $z_s \in \{0, z, 1\}$.
- Modes of production:
 1. *Self-employment*: $w_s = z_s$ ($s = l, m, h$).
 2. *Two-layer teams*: $w_s = n_l \cdot (z_s - w_l)$ with $n_l \cdot h_{2,s} = 1$ ($s = m, h$).
 3. *Three-layer teams*: $w_h = n_l \cdot (1 - w_l) - n_m \cdot w_m$ with $n_l \cdot (1 - z) \cdot h_{3,h} = 1$ and $n_m = n_l \cdot h_{3,l}$.
- Further assumptions:
 1. (Distribution of rents) $w_l = 0$.
 2. (Communication costs) $h_{2,h} = h_{3,h} = h_I$; $h_{2,m} = h_S$; and $h_{3,m} = h_L$. Then, $h_I \geq h_S \geq h_L$.



Predictions and tests

- North has h workers, while South has m and l workers.
- Offshoring occurs when management is in North and production is in South.
- Key prediction of the model:
"The volume of offshoring increases with intermediate skills if domestic communication technology is relatively bad"
- (Robustness) How realistic are the assumptions about communication?

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- Data: (1) Offshoring...FDI; (2) Intermediate skills...SSE; (3) Communication...BCI.
- Key test of the model:
"The volume of foreign direct investment increases more with secondary school enrollment if communication technologies are not available in the host country"
- (Power) How close is the test to the theory?

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- Very elegant modelling and half-hearted attempt to bring it to the data.
- But ... *too much brain power for such a small question!*
- The important questions on this topic are about efficiency and welfare:
 1. When is offshoring efficient? When is offshoring a rent-seeking activity?
 2. When is offshoring only a change in the mode of production? When does offshoring affect the geographical distribution of production factors?
 3. What are the distributional consequences of offshoring in North and South?
 4. How should governments deal with offshoring? (compensation mechanisms, negotiating with firms, ...)
- I look forward to see how AGR tackle these questions in their future work!