

*Why do firms offshore activities that they previously carried out themselves?*

As we have seen above, offshoring has increased tremendously over the last decade. Indeed, it is the prevalence of offshoring that, according to a number of observers, make the current wave of globalization unique and different from previous ones.

First of all, it is important to point out that offshoring incurs important costs. The production process (be it manufacturing or services) needs to be split in its components, with some activities migrating to different countries. Doing so incurs substantial new costs of coordination between headquarters and the foreign affiliates, or the independent supplier (Jones and Kierzkowski, 2001). As an example, the following costs may occur:

- Telecommunication between the different partners of a global value chain
- remote management coordination
- maintaining effective quality control
- transportation for intermediate inputs procured abroad
- travel costs for staff
- search costs for finding adequate foreign partners or recruitment costs

This is not an exhaustive list, of course, but gives some idea of what is involved when a firm makes the decision to offshore part of their production process. It is widely recognized that costs of "coordination" have dropped significantly in the last decade or so (e.g., Arndt and Kierzkowski, 2001). There are two important explanations for this recent trend: first, technological progress and second, liberalization in the world trading system. Let us examine these issues in turn.

Technological progress has arguably changed significantly the way international business is structured around the globe. Due to the rise of data dissemination through the internet people can now gather information and order products from firms all over the world. This implies that costs of searching for potential suppliers are now much lower, as are costs for looking for new staff abroad. The related drop in the costs of electronic data transfers, telecommunications and video conferencing means that communication between headquarters and foreign locations is eased and now possible at a fraction of what it cost previously. This has, in turn, also helped management planning, co-ordination, and has facilitated regular quality control.

Another central aspect of technical progress is that many services that were previously non-tradable have now become tradable (e.g., financial services, back office functions, routine business processes etc.) which implies that the production of services can be located anywhere in the world and traded through electronic communication.

In line with technical progress, cost of travel and transportation have also dropped significantly recently, making it now possible for managers or workers to travel easily between headquarters and foreign affiliates when required. Furthermore, trading intermediate inputs through air, rail, sea freight, or roads, central to offshoring is now relatively less costly than it used to be and can be monitored in real time.

Technological advances have gone hand in hand with policy moves to liberalize further the world trading system, making it easier for trade and foreign direct investment to take place. Negotiations starting under the GATT (General Agreement on Tariffs and Trade) and GATS (General Agreement on Trade in Services) culminated in the founding of the World Trade Organisation, liberalizing many aspects of international trade in goods and services (though with significant exceptions). China's accession to the WTO in 2001 arguably was an important step to incorporate China into global value chains.