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CANADA AND OFFSHORING

Philippe Le Goff
Economics Division

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TABLE OF CONTENTS

CANADA

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INTRODUCTION

In the past several months, not a day has gone by without the Western business press mentioning the economic performance of China or India, two demographic giants with annual growth rates of 8% and 6% respectively. While some businesses are delighted at the prospect of distributing their products to markets with over a billion consumers and growing, others are worried about the effects of competition from Chinese or Indian companies whose products are filling shelves around the world. With cheap and increasingly skilled labour, these companies are becoming ever stronger, sometimes dominant, in a number of sectors and products in international markets. The old industrial countries, meanwhile, are seeing their manufacturing sectors lose ground.

To remain competitive, Western businesses are moving an increasing proportion(1) of their production and operations to countries where wages are lower, such as China and India. Offshoring is not new, and it is not limited to developing countries. After the North American Free Trade Agreement (NAFTA) was signed, many U.S. companies took advantage of much lower production costs to the south and north, and relocated their production. For some time, NAFTA encouraged the development of *maquiladoras* in Mexico. Canada, aided by the weak Canadian dollar, also benefited significantly from U.S. companies' relocation of various production processes (auto parts, film production, call centres, etc.).

While Western consumers appreciate the low prices of products made in China, India or elsewhere, there is a real uneasiness in some political and union circles as to the effects of offshoring on local employment.

(1) John McCarthy *et al.*, "3.3 Million US Services Jobs To Go Offshore," November 2002, http://www.forrester.com/ER/Research/Brief/Excerpt/0,1317,15900,00.html.

In the United States, the decline in manufacturing jobs and the huge trade deficit, which a number of observers link with trade with China, is fuelling the protectionist movement and generating lively debate on the merits of free trade and globalization. Thirty-six states have responded to pressure from their electorate by bringing forward at least a hundred bills to limit the offshoring of service activities.(2) Most of these bills had two components:

- prohibiting companies that have contractual agreements with the United States from using foreign labour on American soil, and prohibiting companies from relocating jobs abroad;
- short of prohibiting the relocation of jobs abroad, seeking to increase the transparency of companies' operations by requiring the employees of call centres located abroad to tell clients where they are located.

Some bills also seek to regulate the transfer of personal financial or medical information abroad by private call centres.

In January 2004, the U.S. Congress passed omnibus legislation(3) that includes an amendment (the Thomas-Voinovich Amendment) preventing the U.S. federal public service from awarding contracts to businesses that subcontract abroad or conduct some of their operations (manufacturing and services) abroad.

The issue is being hotly debated also in France, where the government is redoubling its efforts to understand, quantify and contain the trend. Fear of offshoring has become a key political theme, and the government intends to show that it is in favour of keeping jobs in France. In September 2004, Prime Minister Jean-Pierre Raffarin called for concerted national action against offshoring.(4) Specific measures were announced, totalling over a billion euros:

- creation of an occupational tax credit to retain industry operations in areas with high unemployment;
- creation of a tax credit for companies relocating their operations to France after these had previously been located outside the European Union (EU);

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(2) United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2004: The Shift Toward Services*, September 2004.

(3) *Transportation, Treasury, and Independent Agencies Appropriations Act*, 2004, H.R. 2989, s. 212, "Prohibition on contracts with corporate expatriates."

(4) Anne Rovan, "Entreprises : Un plan en quatre facettes contre les délocalisations d'emplois," *Le Figaro*, 23 September 2004.

- creation of "competitiveness centres" in order to enhance the strengths of areas specializing in an industry, a branch or a technology by encouraging companies, research establishments, and training and education centres to work as part of a network;

- efforts to counter the problem of profits being moved to tax havens by improving legal tools in order to better define revenues that, although generated abroad, could be taxed by the French treasury.

In light of these developments, what position should Canada take on the offshoring of businesses and economic activity? How big is this issue? What are its benefits and drawbacks, and how can we make the most of it or protect ourselves? These are some of the questions addressed in this paper.

THE ABCs OF OFFSHORING

Offshoring is in a sense an extreme form of outsourcing, applied in the context of globalization. Outsourcing refers to a decision by a company to have some activities conducted outside the company – activities that are necessary to its operations, but not considered strategic or related to its distinctive strengths.

The concept of offshoring can be understood more or less narrowly. In the narrow sense, offshoring refers to the transfer of production capacity from a site within a country to a site in another country, and then importing for national consumption the goods and services that had previously been produced locally. Offshoring must not be confused with the relocation of companies and the location of production and investments abroad. Companies are relocated when the production site is moved to another country in order to be closer to that market and sell the product there. As for the location of production abroad, this is a form of foreign investment. The present paper interprets offshoring in the narrow sense of the word only.

Offshoring is actually a very old practice, which economists refer to as the *specialization of labour*. However, improvements in the transport of merchandise, the development of free trade, access to qualified and cheap labour, and above all the huge growth in telecommunications have accelerated offshoring so much that it now includes trade in services and has become one of the cornerstones of the global economy. Some observers have even gone so far as to say that offshoring is simply a new form of international trade.

The specialization of labour is now increasingly becoming a kind of "vertical" specialization by country for each stage of production, and this trend will increase in the future. This specialization has already seen the emergence of companies devoted to a specific stage of production, and the existence of international companies that locate different stages of production in different countries.

Frédérique Sachwald[(5)] has noted that the *fragmentation of production processes* is characteristic of modern economies. Instead of specialization in a product within a given country, we now have specialization at each stage of production within a given industry. This fragmentation has grown since the 1980s, and emerging countries are now gradually increasing their ability to perform increasingly complex tasks, including design and some development work. In short, offshoring increasingly goes hand in hand with globalization.

AN UNDENIABLE FACT, BUT DIFFICULT TO QUANTIFY

As a result of heavy media coverage, offshoring to countries with cheap labour[(6)] is attracting public attention. Some alarmists believe we are witnessing a fundamental shift that could lead to the de-industrialization of all Western countries. Other observers regard the decline in jobs in industry in Western Europe and the United States[(7)] as a symptom of the scale of this phenomenon, which affects the textile, clothing, metallurgy, household appliance, automotive and electronic industries. It also includes the service sector. Many service jobs are now being created in emerging countries in informatics and other fields supported by information and communication technologies, such as business accounting, telemarketing, etc.

It is difficult, however, to measure the extent of offshoring, since no hard statistics on it are publicly available. In trying to quantify the problem and measure job losses in Western countries as a result of trade with countries offering cheap labour, economists proceed with caution, relying on analysis of aggregates.

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(5) Frédérique Sachwald, "Délocalisations : une 'destruction créatrice'?" *Sociétal*, No. 44, April 2004.

(6) The regions benefiting from offshoring are India, the Maghreb, Turkey, Central and Eastern Europe, and Asia (especially China).

(7) In 1950, 34% of American workers were employed in the manufacturing sector, compared with 13% in 2002. Today, 82% of American workers are employed in the service sector. From 2000 to 2002, 10% of manufacturing jobs (1.9 million jobs) disappeared in the United States (Barbara Hagenbaugh, "U.S. manufacturing jobs fading away fast," *USA Today*, 12 December 2002, http://www.usatoday.com/money/economy/2002-12-12-manufacture_x.htm).

The real extent of offshoring over a given period can thus be measured only by carefully combining macroeconomic aggregates (foreign direct investment, trade balance, industry production and employment) with microeconomic analyses of the causes and effects of foreign investments.

A. The United States

In the United States, a recent study by the Government Accountability Office[8] indicates that even if offshoring is on the rise, it is still in all likelihood of very marginal importance relative to the size of the American economy. Given the available data, it would be even more difficult to accurately measure the impact of offshoring on employment and the economy.

Some international consulting firms[9] have nevertheless claimed that the trend is only just beginning and that offshoring from the United States will increase by 30%-40% annually by 2008. Once again, however, not everyone agrees on this predicted growth: some analysts such as Daniel Drezner maintain that the volume of services offshored did not increase in 2003 and that, all told, nearly 90% of jobs in the United States require geographic proximity.[10] In short, there is no consensus in the United States regarding either the extent and future of offshoring or its impact.

B. The European Union

In the EU, the European Monitoring Centre on Change[11] stated recently that offshoring accounts for only a small portion of jobs lost in Europe. Since the start of 2002, the Centre has identified 1,460 companies that have announced the loss of 777,000 jobs in the EU-15, Poland, the Czech Republic and Slovakia. Only 4.8% of those losses can be attributed to offshoring. Three-quarters of them were due to restructuring and 15% to bankruptcy. This

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(8) United States Government Accountability Office, "Current Government Data Provide Limited Insight into Offshoring of Services," GAO 04-932, September 2004.

(9) McKinsey & Company, "Who Wins in Offshoring," *McKinsey Quarterly – Global Directions*, No. 4, 2003.

(10) Daniel Drezner, "The Outsourcing Bogeyman," *Foreign Affairs*, May-June 2004, http://www.foreignaffairs.org/20040501faessay83301-p0/daniel-w-drezner/the-outsourcing-bogeyman.html.

(11) Based in Dublin, Ireland, the Centre is dependent on European institutions.

count, drawn from figures reported in the press in the various EU countries, does not claim to be either exhaustive or scientific. The lack of hard data lends credibility to the findings and conclusions of a working group of the French Senate. In a lengthy and very detailed report, the working group stated that:

> Economists all say that, regardless of the criteria used, offshoring is not a statistically significant problem at this time, and that its effects on the country's industrial capacity and employment are extremely limited.(12)

Like the United States, the EU can look to a myriad of consultants who predict a huge increase in offshoring by European companies. According to a detailed study on the offshoring strategies of large European companies, conducted jointly by the United Nations Conference on Trade and Development (UNCTAD) and Roland Berger Strategy Consultants, offshoring across Europe will increase considerably, since nearly half of the companies surveyed expected to offshore additional services in the coming years. The study was based on a representative sample of 500 large European companies.(13)

According to Thomas Eichelmann, senior partner and member of Roland Berger's world executive board:

> There are two kinds of European companies: a good many already have offshore activities and are considering offshoring more, while others have never moved any activities offshore and do not expect to do so in the near future.(14)

It should be noted that European companies are generally considered to be behind their American competitors with respect to offshoring, and over 50% of them consider that the American model of offshoring is not applicable to Europe. The primary factors accounting for the differences between the two economic blocs are the regulation and the relative flexibility of employment markets, the diversity of their cultures, and the status of English as a world

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(12) Francis Grignon, *Délocalisations : pour un néo-colbertisme européen*, Information Report No. 374 (2003-2004), prepared by the groupe de travail sur la délocalisation des entreprises de main-d'œuvre (Working Group on the Offshoring of Businesses and Labour) for the commission des Affaires économiques et du Plan (Economic Affairs and Planning Commission), Senate of France, June 2004, http://www.senat.fr/rap/r03-374/r03-3741.pdf [translation].

(13) UNCTAD and Roland Berger Strategy Consultants, *La délocalisation des services prend son essor en Europe*, Press Release, June 2004, http://www.unctad.org/Templates/Webflyer.asp?docID=4865&intItemID=2807&lang=2.

(14) *Ibid.* [translation].

language. The linguistic diversity of European countries represents an obstacle to offshoring. This finding is corroborated by the fact that the United Kingdom accounts for more offshoring than any other European country, with 60% of offshore European jobs.(15)

DEVELOPING COUNTRIES CATCHING UP

The space travel of a Chinese astronaut last year, in a craft designed and manufactured in China as part of an exclusively Chinese space program, had a powerful psychological impact on Western countries. It was a powerful symbol for the future, especially as regards the ability of countries recently considered as "developing nations" to accommodate offshore activities in key valued-added sectors. A number of them are now catching up with Western countries in terms of capabilities and labour skills in leading sectors, while at the same time keeping salaries much lower.

A study by the U.S. National Science Board has found, for instance, that while the United States remains the world leader in science and technology, and is even widening the gap in relation to other G7 or OECD countries, the gap is shrinking in relation to countries such as China, Russia, Taiwan, South Korea, Malaysia and Singapore.(16) American supremacy in scientific research, as measured by the number of articles published by U.S. researchers in major scientific journals around the world, is weakening. The relative decline of the United States indicates that leading scientific research capacity is beginning to emerge elsewhere in the world.

A number of other indicators point to growing strengths in science and technology in these countries. Those mentioned above – and others – are capturing an ever-larger share of the world market for products with a high science and technology component. Their exports of technology products are becoming ever more competitive internationally with high-value-added products in the G7 and EU industrialized countries. This trend is supported by a growing number of graduates in cutting-edge science and technology fields and by aggressive policies to prevent brain drain and to repatriate exiles. These countries are also endeavouring to benefit from the knowledge and experience acquired by citizens who have worked abroad, especially in the United States, Europe and Canada.

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(15) *Ibid.*

(16) U.S. National Science Board, "The United States in a Changing World," *Science & Engineering Indicators 2004*, May 2004, http://www.nsf.gov/sbe/srs/seind04/c0/c0s1.htm.

A. China, the World's Factory

While statistical agencies in industrialized countries try to measure the extent of offshoring, large international consulting firms are offering more and more seminars on the issue and welcoming the prospect of a promising new field. At the same time, companies are investigating or implementing options for offshore production, and governments are responding to public opinion. The following figures are startling.

According to the *Quotidien du peuple*, citing a report by the Changcheng Research Institute on technological innovation and products manufactured in China, China has become the fourth manufacturing power in the world.(17) China ranks first in the world in the production volume of a hundred or so products. These products cover about ten sectors, including household appliances,(18) telecommunications devices, the textile industry, the pharmaceutical industry, mechanical equipment and the chemical industry.

The numbers speak for themselves. In electronic components and telecommunications equipment, for example, China produces 50% of telephones and 75% of clocks and watches in the world. The pharmaceutical industry is also doing very well, as China accounts for 60% and 65% respectively of the penicillin and terramycin produced in the world and 50% of the vitamin C. In terms of mechanical equipment, China produces 83% of the world's tractors and containers.(19)

China offers very favourable conditions for the development of manufacturing industries: a huge consumer market, relatively cheap labour, great flexibility in production and relatively complete allotment facilities. Its weaknesses must not be overlooked, though. Few Chinese products are among the top brands in the world. The cost of distribution, which is very high due to the dispersed management of the flow of merchandise, is a serious hindrance to the development of Chinese industry. Insufficient infrastructure and the lack of manpower also seriously hamper the growth of Chinese manufacturing.

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(17) "Une centaine de produits manufacturés dont le volume de production chinoise parvient au premier rang dans le monde," *Quotidien du peuple*, 14 August 2002, http://french.people.com.cn/french/200208/14/fra20020814_56531.html.

(18) In 2001, China accounted for the following percentages of world production: 29% of televisions, 24% of washing machines, 16% of refrigerators, 30% of air conditioners and over half of all fans and cameras (*ibid.*).

(19) *Ibid.*

B. India, the World's Office

Nowadays – unlike previously – offshoring increasingly includes many services that were hitherto excluded because they require direct contact, or at least proximity, between the producer and consumer, since the services are for immediate use and cannot be stockpiled. The boom in information and telecommunications technologies in the 1990s has made that change possible, at least in part.

All mass production and repetitive services can now be located offshore where labour is considerably cheaper. Some argue that the full range of services, from public relations to administrative services, can be located offshore, including finance, accounting, informatics, human resources management and other central services. In short, no service would be excluded from consideration and most could be located offshore. A study by the A.T. Kearney consulting company(20) shows that the more highly developed the industry, the more complex the activities that are located offshore.

Moreover, in addition to offshoring their support activities, a number of large companies are now diversifying the geographic location of their research and development activities. They are now locating operational R&D (design, process documentation, product development, etc.) and engineering activities offshore, representing a large share of their operating costs. In this field as well as in industrial production, international division of labour is competing with national sites.

In this regard, India is playing a prominent role internationally in terms of offshoring, especially in the new technologies and services sector, both complex and less complex – so much so that it has been dubbed the "world's office." A recent study(21) by A.T. Kearney named India as the most profitable country in which to operate service delivery operations.

Like many other emerging countries, India has many key assets to offer international investors, including an abundant supply of flexible and economically competitive labour. India stands apart from other developing countries, however, by virtue of the high general skills level of its workers: not only is the supply abundant, but there is an inexhaustible

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(20) Mike Wheeler, Sanjay Agarwal and Eric Narsolis, "Business Process Outsourcing: Will Chemical Companies Go Offshore?" *Chemical Market Reporter*, Vol. 265, No. 4, 26 January 2004, http://www.atkearney.com/shared_res/pdf/CMR_BPO_Article_lckd.pdf.

(21) A.T. Kearney, *Where to Locate? Selecting a Country for Offshore Business Processing*, Chicago, 2003, http://www.atkearney.com/shared_res/pdf/Where_to_Locate_S.pdf.

source of qualified workers in many fields. With a population of one billion, India has 650,000 engineers, all of whom speak English, and about 29 million university students. And this supply of “grey matter” is growing steadily, with high-level engineering schools producing close to 165,000 young graduates every year.

India does not merely specialize in computer services and English-language call centres. The country has made massive investments in leading technology sectors such as the nuclear and aerospace sectors as well as pharmaceuticals with a specialty in generic products.

PROS AND CONS OF OFFSHORING

Economic history has often shown that what some people regard as risks and challenges, others see as benefits and opportunities to be seized. This part of the paper presents an overview of the benefits and disadvantages generally associated with offshoring.

A. Benefits

Not everyone is worried about offshoring. A number of economists and academics argue that at some times and under certain circumstances, offshoring should increase and accelerate, including when competition is strong, resources are scarce and it is imperative to reduce costs in order to increase a company’s efficiency. Offshoring is sometimes necessary for companies to survive.

Offshoring part of the production process can certainly have positive effects on employment, insofar as it allows a company to maintain or increase profitability. Secondly, offshoring can enable a company to maintain its competitive position or even protect it from going out of business, which would result in greater job losses than those caused by offshoring. Offshoring can also increase a company’s market share and production, which in turn could lead it to recruit more workers, in some cases in different fields to promote innovation and quality upgrading.

In this regard, a study undertaken by Lionel Fontagné and Sébastien Jean[22] for a working group of the French Senate[23] found that investing abroad usually improves the balance

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(22) Lionel Fontagné and Sébastien Jean are, respectively, the director of the Centre d’études prospectives et d’informations internationales (Centre for Information and Future Studies on International Affairs) (CEPII) and senior economist at CEPII.

(23) Grignon (2004).

of trade of the investing country. According to these economists, who are members of the Centre d'études prospectives et d'informations internationales, each euro invested abroad generates 0.59 euros in exports and 0.24 euros in imports, representing a trade surplus of 0.35 euros, which would likely have a positive impact on employment. Moreover, the two economists note that direct investments abroad can accelerate the rise in relative demand for qualified labour, largely because they create the need for supervisory and liaison skills.

Similarly, a study by McKinsey Global Institute (MGI)(24) reports that the American economy reaps $1.12 to $1.14 (78% of the total value created per dollar initially invested) for each dollar an American company invests in India rather than the United States, in the business services sector. At the same time, the Indian economy reaps some $0.33 (22% of the total value created per dollar initially invested), in the form of fiscal revenues ($0.04), local jobs resulting from offshoring ($0.10), profits ($0.10) and sales made by Indian suppliers ($0.09).

According to the MGI study, companies and economies that locate certain activities offshore enjoy the following benefits:

- *Reductions in costs*: For each dollar spent offshore, American or other companies save $0.58, primarily in wages. The quality of work is assumed to be identical. Cost reduction is by far the main source of value created for the economy whose businesses locate offshore.

- *Increases in exports*: Local businesses that offer their services to offshore businesses purchase goods and services from foreign suppliers, thus increasing the exports of Western economies. The MGI study showed that the value of new exports is $0.05 for each dollar spent offshore.

- *Repatriation of profits*: A number of suppliers of goods and services in India are incorporated in the United States and other Western countries and can thus repatriate their profits. According to MGI, $0.04 of each dollar spent offshore falls into this category.

- *Reassignment of workers*: The MGI study shows that offshoring low-skill jobs makes it possible to reassign workers to economic sectors offering better jobs, thus improving the population's standard of living. This increased value added with respect to the workforce represents a return of $0.45 to $0.47 for each dollar spent offshore, based on historical data for the United States.

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(24) McKinsey & Company (2003).

This last estimate is certainly debatable and apparently does not include the social costs associated with economic changes in general and with the transition and restructuring of affected industrial regions in particular. It is clear, however, that in the medium to long term, offshoring offers a way to make use of human resources where they are located. Some observers accordingly see offshoring as a solution to the shortages of workers anticipated as a result of the massive retirement of baby boomers in the coming years.

For consumers, offshoring clearly lowers product prices. But there is more. Consumers ultimately benefit from the creativity and innovation of the thousands of skilled workers and researchers hired at a fraction of the price of their Western counterparts by businesses locating part or all of their activities offshore. This difference in the price of labour can have a multiplier effect on innovation, which in turn benefits consumers.

B. Drawbacks

There is no doubt that offshoring is synonymous with short-term job losses and that the newly unemployed will not necessarily benefit from their former company's increased profitability. Therefore, while offshoring may have a limited macroeconomic impact, it will be sorely resented locally.

While the benefits of international trade are spread throughout the economy, its costs are highly concentrated. When a region loses a large number of jobs due to economic globalization, hundreds if not thousands of workers and their families fall victim to global competition. It is this local dimension that accounts for politicians' and decision-makers' quick reactions to offshoring, rather than the actual number of jobs affected. Evidently, there is a disconnect between a company for which offshoring represents a solution, and the area where the company is located, for which offshoring is a problem.

In this regard, offshoring is first and foremost a local issue with socioeconomic implications for local public authorities.[(25)]

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(25) The loss of 850 jobs in the textile industry in Huntingdon, Quebec, in December 2004 is a good example.

OFFSHORING: CANADA'S POSITION

In Canada, unlike the situation in the United States or EU countries, offshoring issues are not currently a key public concern. Nonetheless, Canada is not immune to offshoring, and Canadian companies in the manufacturing and service sectors do locate some of their activities abroad, sometimes with negative impacts. The challenge to Canadian companies posed by the elimination of quotas on textiles imported from China as of 1 January 2005, and also by the increased value of the Canadian dollar, clearly illustrates this reality.

The lack of debate on the issue of offshoring outside economic circles may be due in part to the fact that Canada has benefited greatly from offshoring. Canada ranks high among the most attractive host countries for companies wishing to locate abroad to improve their competitive or financial position, according to the "Offshore Location Attractiveness Index" produced by A.T. Kearney.[26]

This firm notes that a country's relative attractiveness can be measured by three types of criteria, to be weighted according to the priorities of the company offshoring its activities:

- human factors relating to know-how (training, availability, flexibility, etc.);
- structural factors relating to the environment (infrastructure, quality of public services, political stability, etc.); and
- financial factors (cost of labour, capital costs, taxes, etc.).

In 2004, Canada ranked eighth for informatics services and services to companies, behind India, China, Malaysia, the Czech Republic, Singapore, the Philippines and Brazil. This favourable position of an industrialized country such as Canada is due to its strong infrastructure, a highly educated population, and a clear and forward-looking policy on hosting companies (specialization, proactive canvassing of companies, etc.), in spite of a high financial index.

Canada's favourable position in the services sector is corroborated by the UNCTAD report,[27] which states that Canada is among the few developed countries[28] that

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(26) A.T. Kearney, *Making Offshore Decisions, A.T. Kearney's 2004 Offshore Location Attractiveness Index*, Chicago, 2004, http://www.atkearney.com/shared_res/pdf/Making_Offshore_S.pdf.

(27) UNCTAD (2004).

(28) In its 2004 world investment report, UNCTAD stated that Canada, along with the Republic of Ireland, India and Israel, has captured 70% of offshore service industries, an annual market of US$32-40 billion in 2001 (according to UNCTAD and the McKinsey Global Institute). To put this in perspective, though, this potential market represents just 0.2% of the international trade in services.

attract most of the offshore services, including call centres, informatics services and regional headquarters.

A.T. Kearney also noted that the potential market that the host country represents is a major factor in the stability of the investments made there. In this regard, Canada's proximity to the United States, combined – until recently – with the weakness of the Canadian dollar as compared to the American dollar, have been key factors for a number of businesses wishing to serve the North American market.

Finally, the study by A.T. Kearney shows that the choice of destination country is dictated not solely by hard data (costs, skilled labour and time difference), but also by broader factors such as the conduct of competitors, promotion campaigns by the destination country, cultural affinities and the domestic influence of foreign subsidiaries. Canada's favourable ranking proves, according to this consulting firm, that it is possible to bring factors other than the cost of labour to bear in order to attract companies to a given country.

CONCLUSION: A STRONG TREND THAT SHOULD BE MONITORED

Over time, with new technologies and the liberalization of trade, the offshoring of company activities will become significant. It will no longer concern only the textile industry or informatics services, but all industries, all services and all roles, including the most complex. A number of companies are already starting to offshore their research centres and headquarters. Leaving will be seen as a profitable investment. Setting economic policy will become difficult because it will be easier for companies to counter the social measures they do not like by simply locating offshore.

On the other hand, competition within given industry niches, the mobility of highly skilled labour and the development of scientific and technological expertise throughout the world will inevitably result in the gradual harmonization of the social conditions of production around the world. To avoid low costs being the sole determinant of offshoring, trade negotiations will ultimately have to take unequal working conditions into account: developing countries might no longer have access to rich countries' markets, unless they undertake to gradually establish social rights similar to those of industrialized countries where they want to trade. This requirement would reduce their current advantage with respect to labour costs.

Until this ideal becomes a reality, though, Canada might consider making education – the key factor supporting its competitiveness, and hence Canadians' quality of life – one of its top national priorities. In this regard, the Canadian dollar's significant appreciation against the American dollar in the fall of 2004, which threatened thousands of subsidiary export market jobs,(29) serves as a reminder that a country's competitive position should never be taken for granted.

As Danielle Goldfarb of the C.D. Howe Institute has noted, "the data limitations can limit our understanding of offshoring but do not in any way prevent us from reacting and responding to it."(30) The goal is not to prevent offshoring – which would mean forgoing its benefits, as well as distorting market laws – but rather to prevent its harmful effects. In this regard, the best choice for both the public and private sectors is to invest in education and workforce training. This will help workers become more flexible and enable Canada to maintain its economic capacity to attract companies and investment.

With respect to trade policy, Canada will benefit from continuing to encourage foreign investment and promote free trade. Protectionism would run counter to its interests. It is also in Canada's interests to resist American protectionist measures, which limit the ability of companies located in the United States to locate some of their activities in Canada.

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(29) A study by the Canadian Autoworkers' Union published on 6 December 2004 stated that if the Canadian dollar stays at US$0.85, 400,000 manufacturing jobs will be lost in Canada by 2007; see http://www.caw.ca/news/pressroom/index.asp.

(30) Danielle Goldfarb, "How Canada Wins from Global Services Outsourcing," C.D. Howe Institute, Commentary 206, November 2004.