

The Future of Offshoring: Fiscal, Social, and Political Considerations

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Independent advisor

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Background

- Independent Advisor (DC policy, AM start-ups)
- Ex DB (AM ExCo; GI Head: Retirement, Structured Products, Equity Trading)
- Ex ABN Amro (GI Head: Exotics, Hybrids, Structured Retail; Prop Trader)
- Ex Theoretical Particle Physicist (Cambridge, Sussex, and Vanderbilt)
- Used Offshoring mostly in R&D (add-ons to existing strategies)
- Blogger and speaker on sustainability, government debt, demographics (karlstrobl.com)

Background

You, The Audience:

- Work In Financial Services
- Are Interested in Outsourcing and Offshore Outsourcing of Work
- Are on Top of your Job
- And don't enjoy talking about it any more, to your dinner-party guests, to your mother-in-law, or in fact anyone outside your line of work.

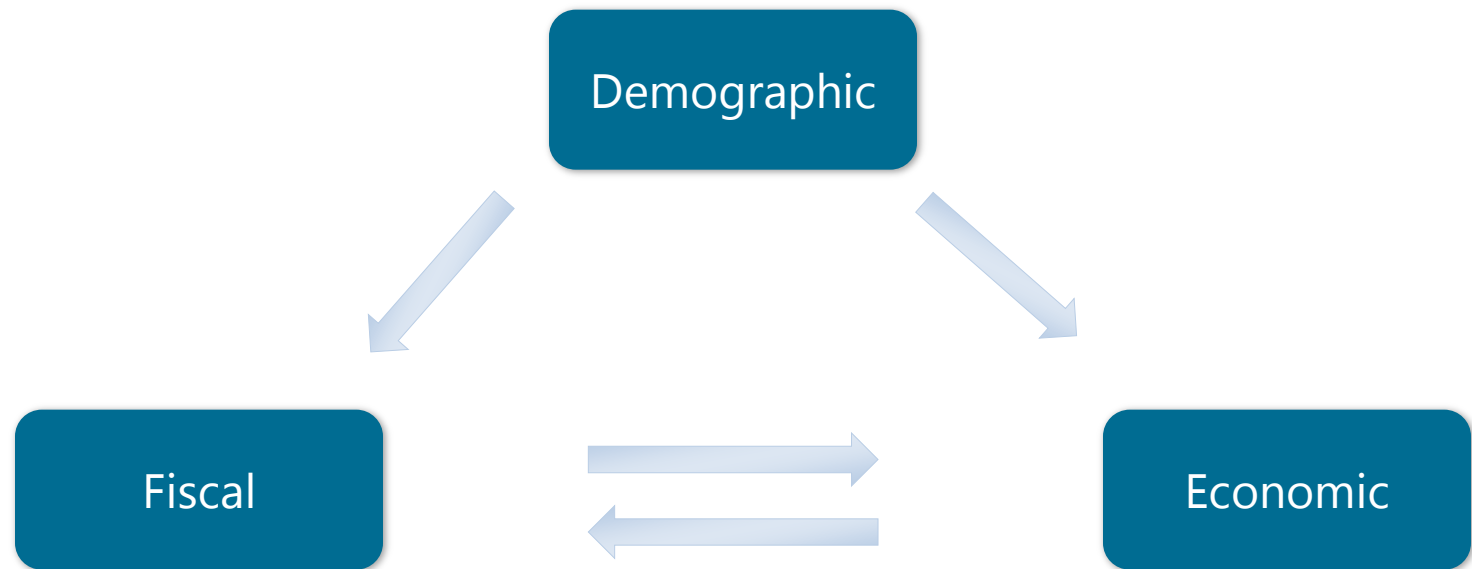
In fact...

Your Social License to Operate is at Risk!



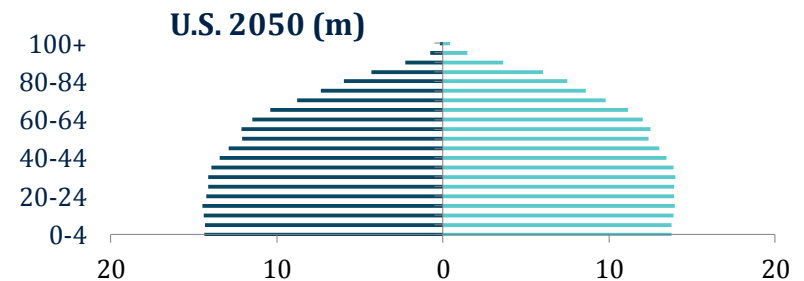
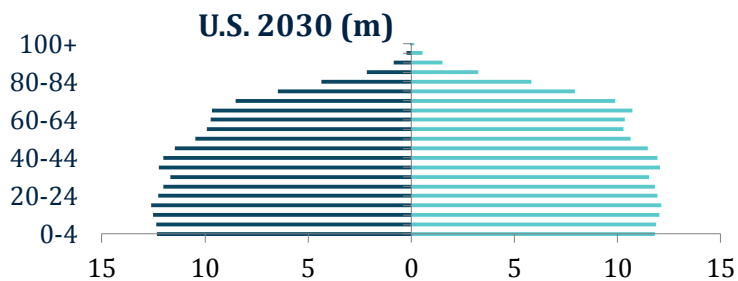
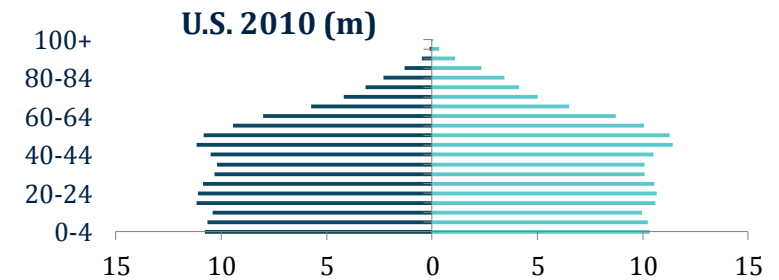
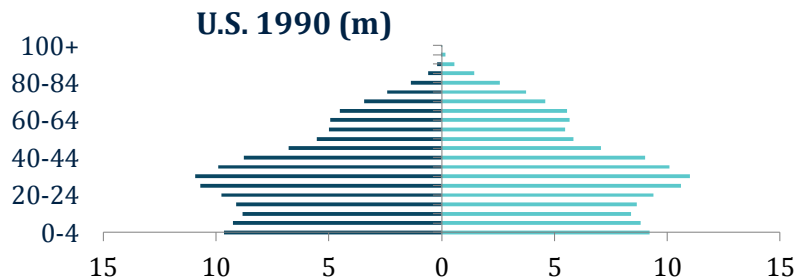
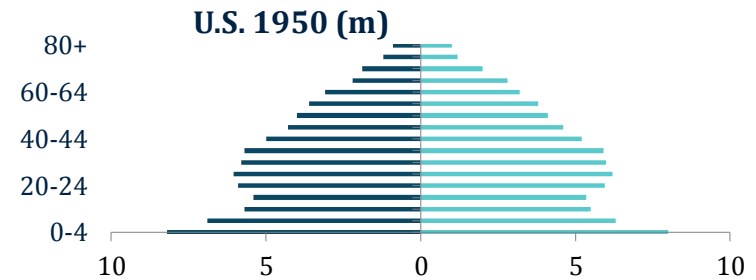
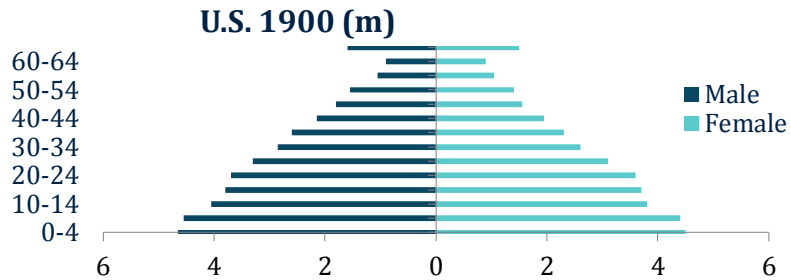
Are you good for Society? Are you good for Jobs? Are you even good for the economy?

Overview: The Mega Trends



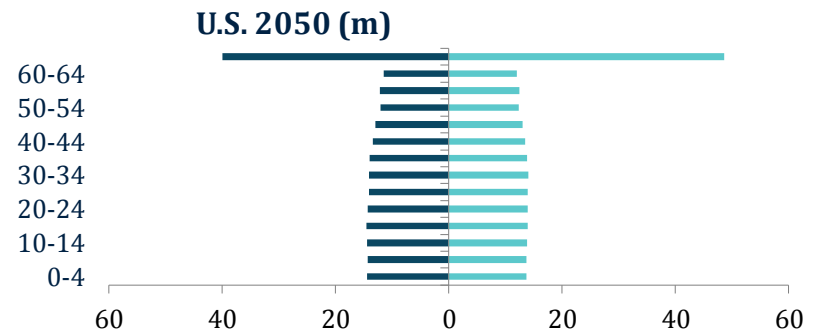
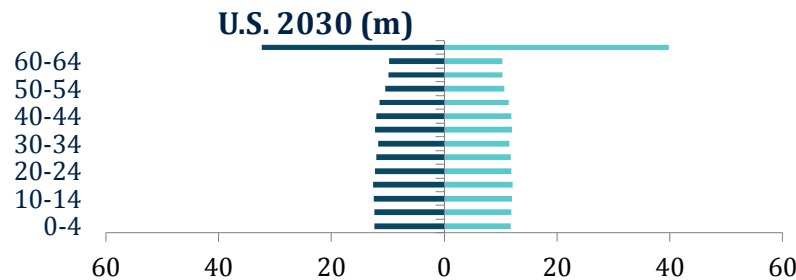
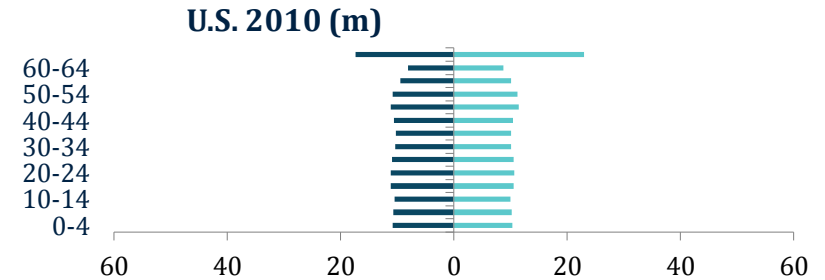
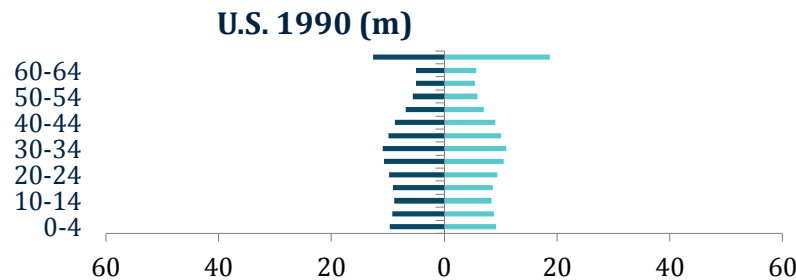
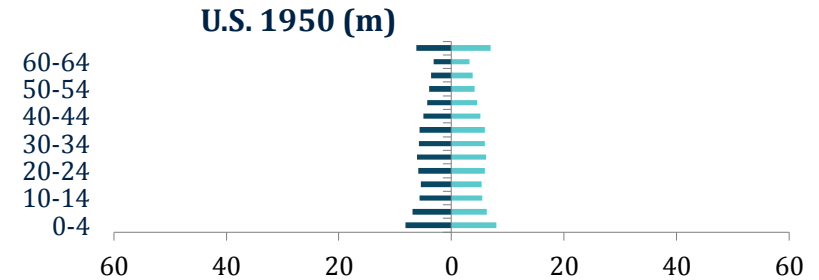
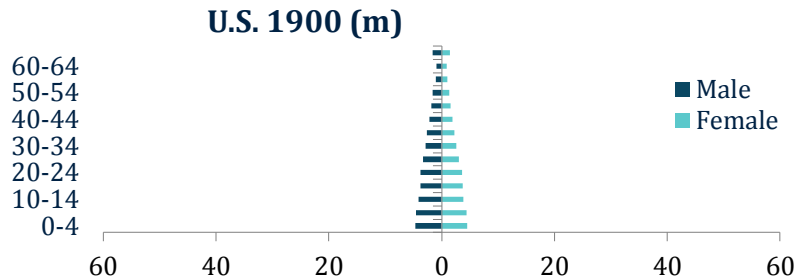
Demographic

US Age Pyramids: The Way They Show it to You

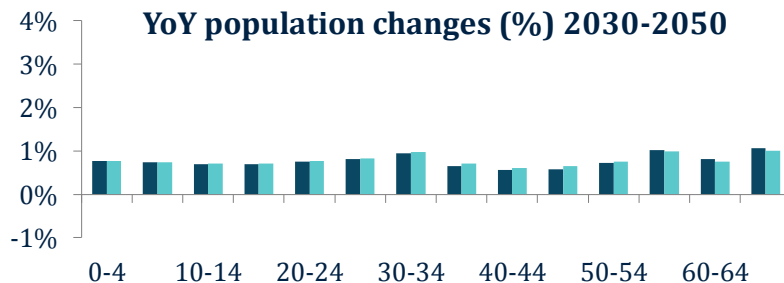
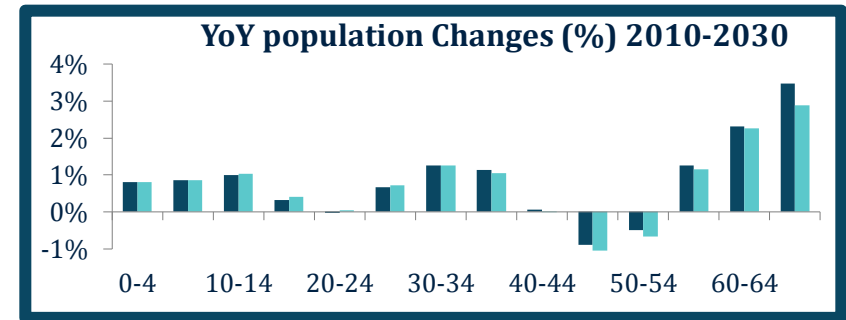
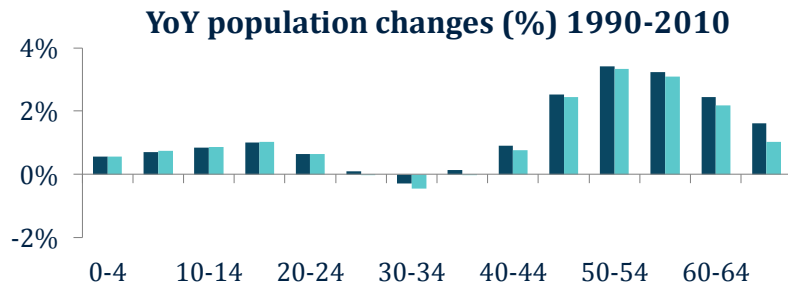
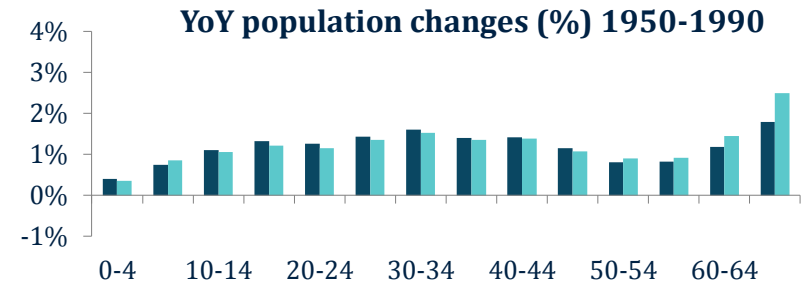
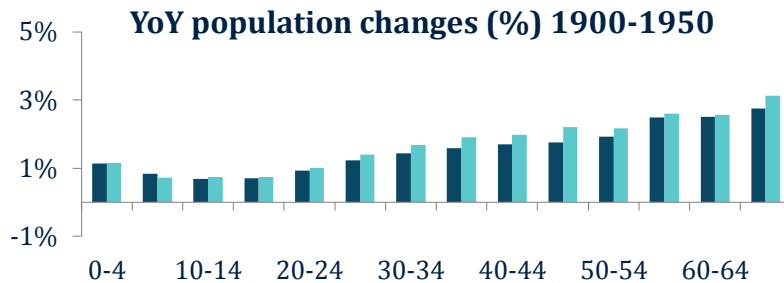


US Age Pyramids: The Like-for-like Comparison

(all on the same scale)

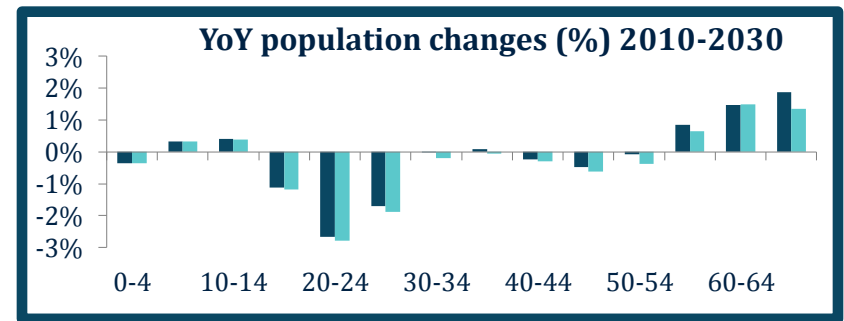
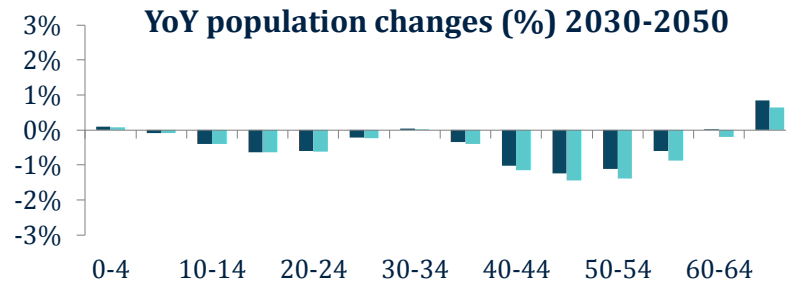
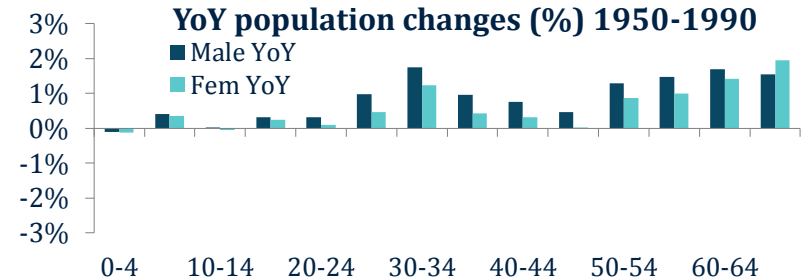
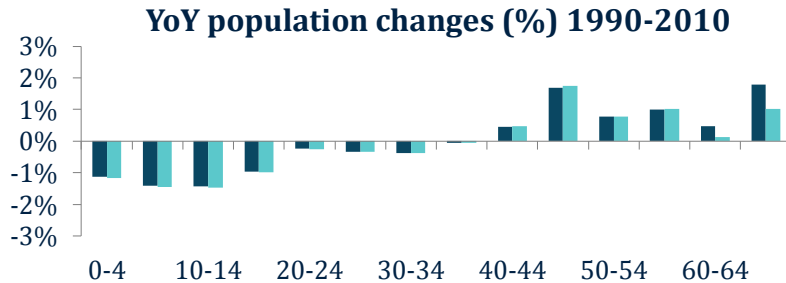


The US is Aging ... And The Radical Shift is Now



By 2030, the population will have found a new meta-stable state...**the big shifts are now, in the next 20 years!**

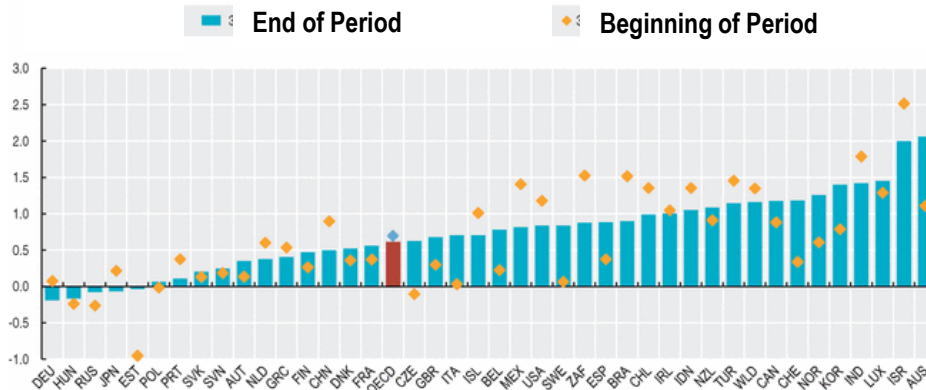
Europe in Much Worse Shape



From now, Europe is forever losing workers of all ages, and gaining pensioners

Demographic Trends OECD

Population Growth Rate



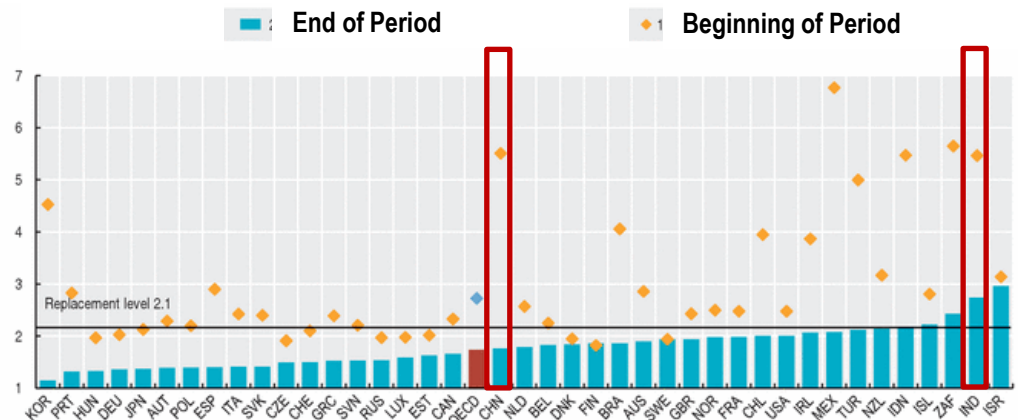
Statlink <http://dx.doi.org/10.1787/888932502676>

Population Growth Rates are positive

Falling in some countries

Rising in others....

Fertility Rates (children born to women aged 15 to 49)



Statlink <http://dx.doi.org/10.1787/888932502714>

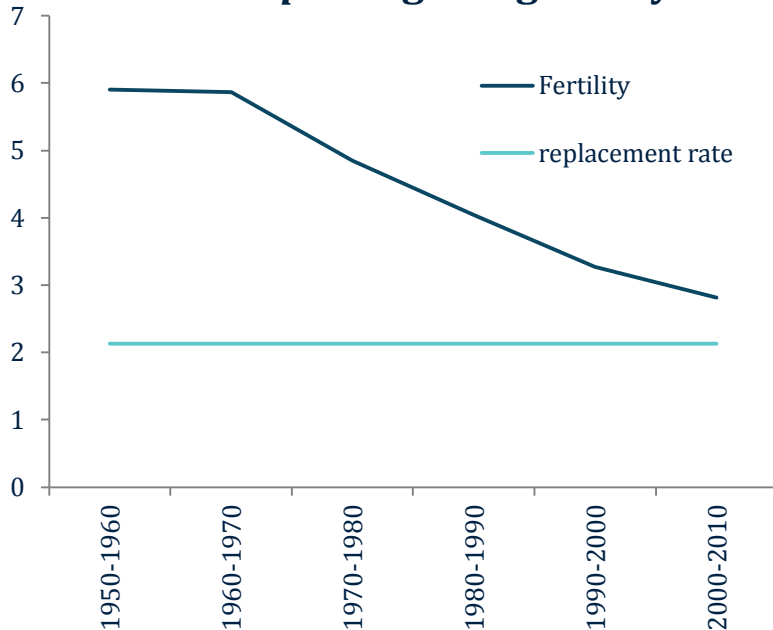
Birth Rates are falling in all countries

They have more than halved in many, and esp. in the most populous countries India, China (see frames)

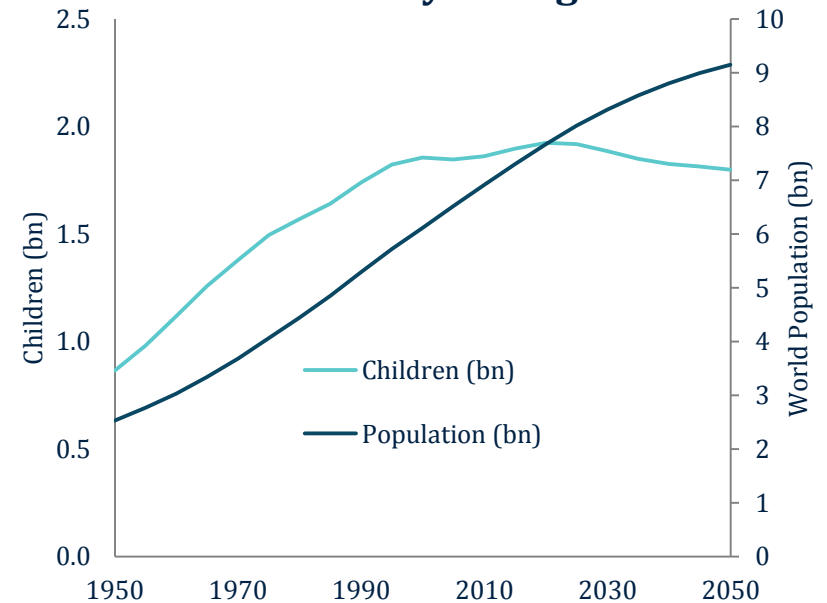
Birth Rates already below replacement rates almost everywhere

Demographic Trends: World

**Fertility in the
less-developed regions globally**



**World population of children
is already falling**



Source: UN Department of Economic and Social Affairs

Demographic Mega Trends: **Conclusions**

- **The Return on Human Capital will outperform the return on financial capital**
- **The Cost of Human Capital will outpace the cost of financial capital**

Fiscal

Immigration Will Not Bail US Out of Tax Shortfalls

"By 2037 the Social Security Trust Fund will be exhausted . [...]"

"We need to resolve these issues soon"

– **Michael J. Astrue**, Commissioner,
Social Security Administration

No fiscal policy or growth expectations can reduce this liability to a sustainable level

The PV of US federal liabilities

US\$tn	2005	2010	CAGR (%)	Now
Gross Fed. Debt	7.9 ⁽¹⁾	13.3 ⁽²⁾	11.0	16.8 ⁽²⁾
Social Security (accrued benefits)	11.1 ⁽³⁾	14.5 ⁽⁴⁾	5.5	16.3 ⁽⁴⁾
Medicare & Medicaid (PV of accrued benefits)	55.9 ⁽⁵⁾	95.5 ⁽⁴⁾	11.3	85.6 ⁽⁴⁾
TOTAL	74.9	123.3		123.4
Total (% of GDP)	481	790	10.5	787

(1) Source: www.whitehouse.gov

(2) Source: US Treasury

(3) Source: Social Security Trustees Estimate according to the National Center for Policy Analysis

(4) Source: Federal Reserve

(5) Source: Mid-Range Estimates of the National Center for Policy Analysis

Immigration Will Not Bail US Out of Tax Shortfalls

- Europe Migration: In 1997, Europe had 950,000 immigrants p.a.
 - To keep population constant, **you need 2x more**
 - To keep working population, **you need 4x more**
 - **To keep dependency ratio, you need 30x more**
(about the size of Canada, Texas, or $\frac{1}{4}$ of Mexico)
 - **In Germany, you need 40x more**, and by 2050, 80% of Germans would be immigrants

Source: *Replacement Migration*, UN Report (2001)

- UK: "We will continue to work hard to bring net migration down from the 100,000s to the 10,000s by the end of this Parliament!"
- Total liability to GDP ratio in Europe is 434%

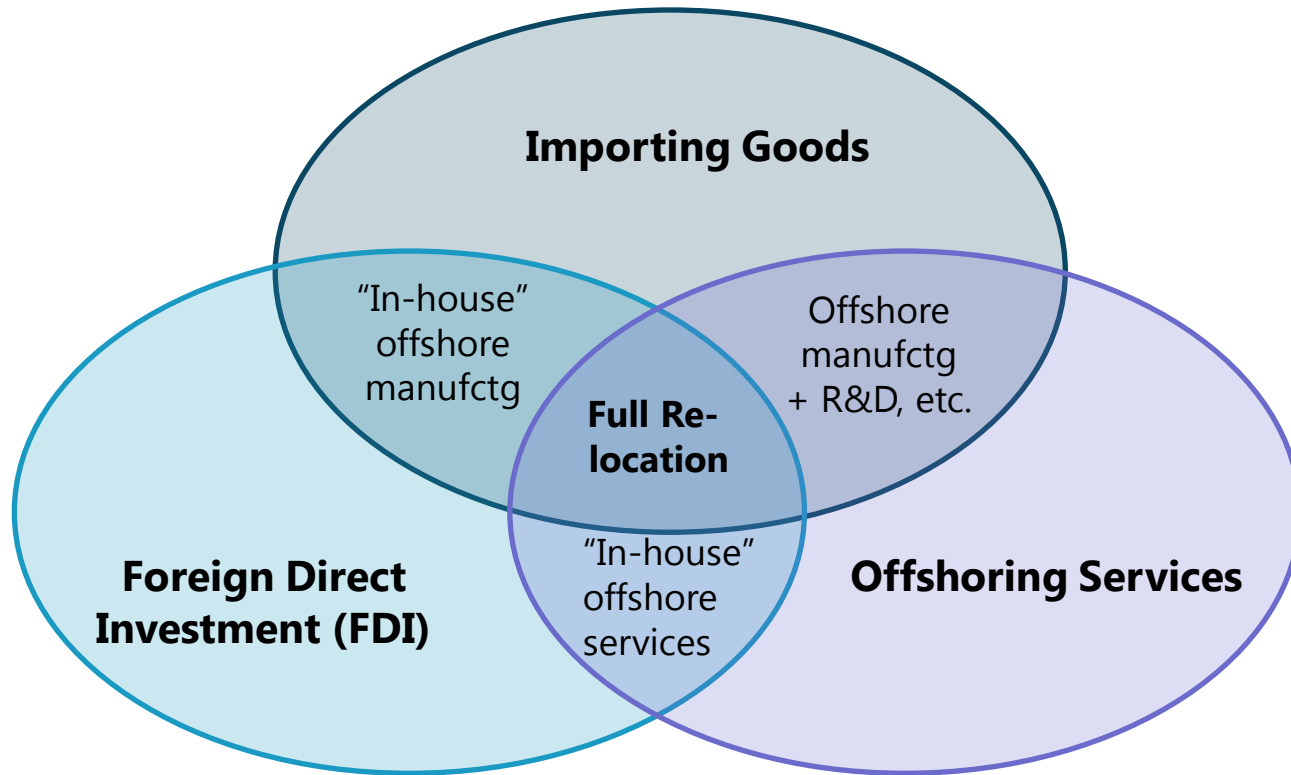
Source: Jagadeesh Gokhale, *National Center for Policy Analysis*, Jan 2009

Servicing National Debt: The Inescapable Facts

1. Real growth \geq Interest rate – Inflation (or Bust!)
2. Real growth =
Growth in number of workers \times Growth in productivity per worker
3. Growth in number of *domestic* workers < 0
- **Solution: Any combination of**
 - Massive immigration
 - Inflation/Devaluation
 - Constant productivity growth
 - Sovereign default
4. **There is no fifth solution**

Economic

Three Sides of Foreign Trade



Services Outsourcing Still at a Very Low Level

- Total outsourcing
 - 20-30%: Germany, Spain
 - 10-19%: China, UK, Italy, France
 - 7-9%: US, Japan
- Services only outsourcing
 - 2-3%: UK, Spain, Germany
 - 1-2%: France, Italy
 - <1%: Japan, China, US

Source: OECD, Input-Output Database

But Domestic Employment Trends go the Other Way

- Manufacturing
 - 723,000 jobs lost over the period
- Services
 - 15.8m jobs created over the period

Source: OECD, Input-Output Database



Could there be a correlation?
Low Outsourcing ↔ High Job Growth

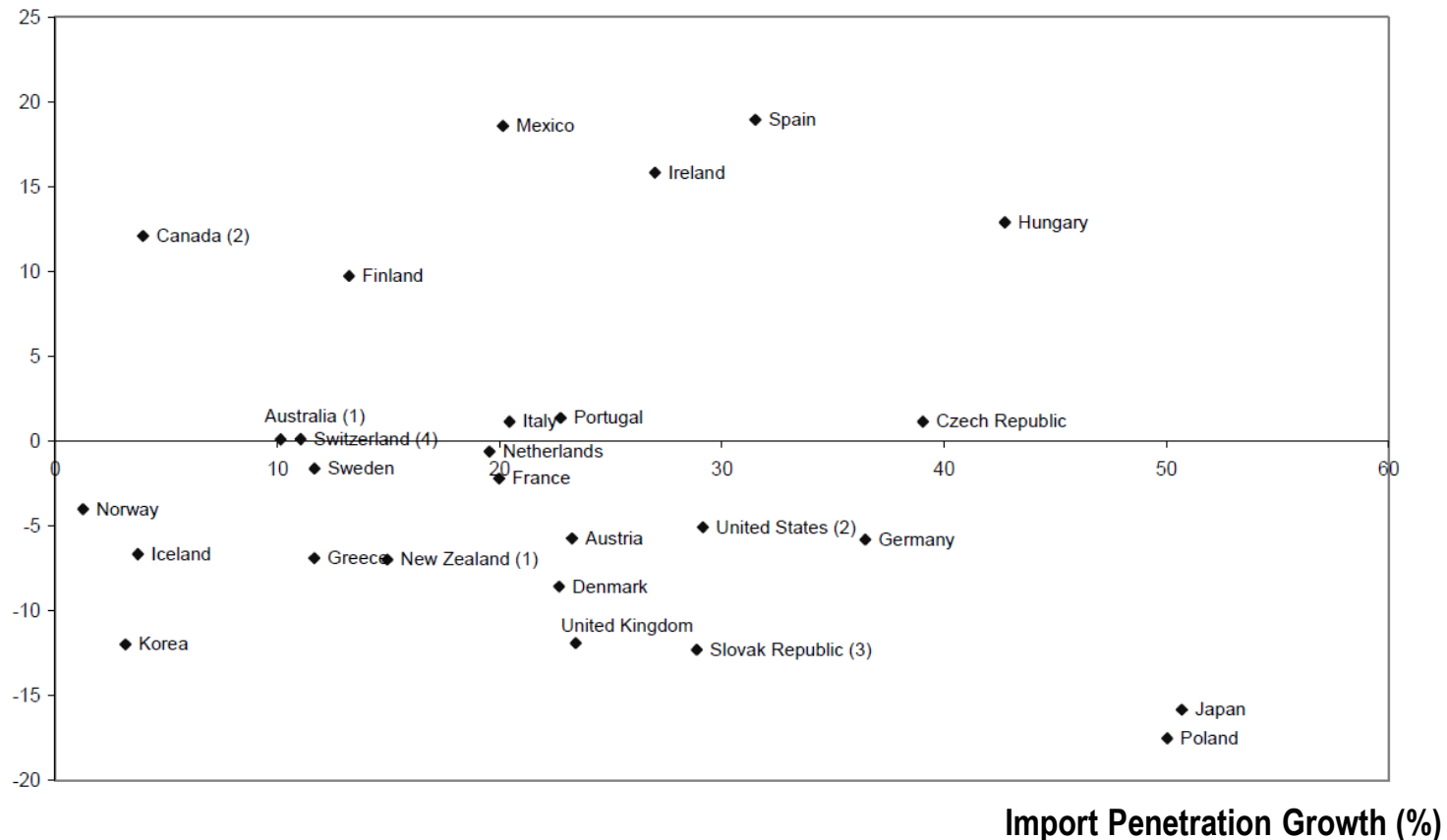


Are you a job-killer?

No! There is No Correlation Between Import Penetration and Employment Growth

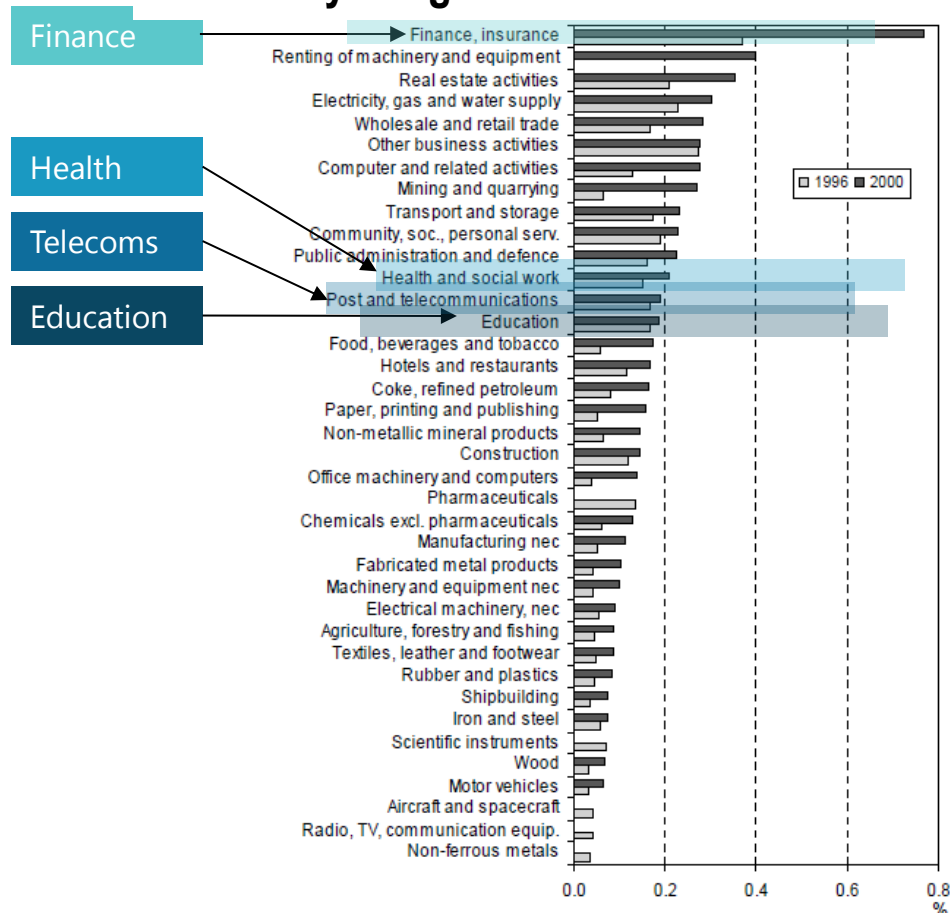
Trends in employment and import penetration rate, Manufacturing, 1995-2002

Employment Growth (%)



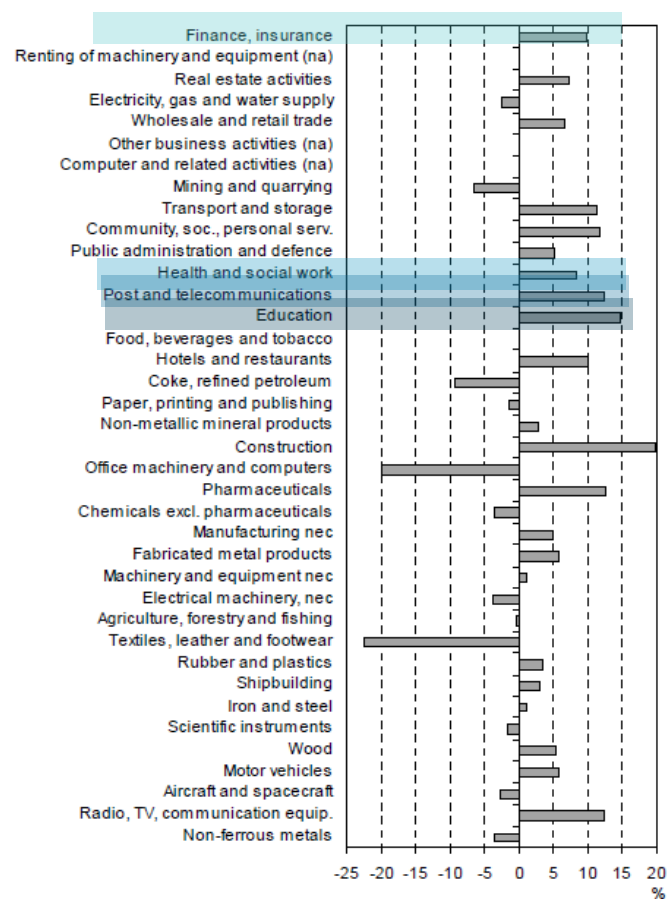
Particularly in Services, Sectors with a High Degree of Offshoring are Those With the Highest Job Growth

**USA – Index of outsourcing of services
Abroad by the goods and services industries**



Source: OECD, Input-Output database.

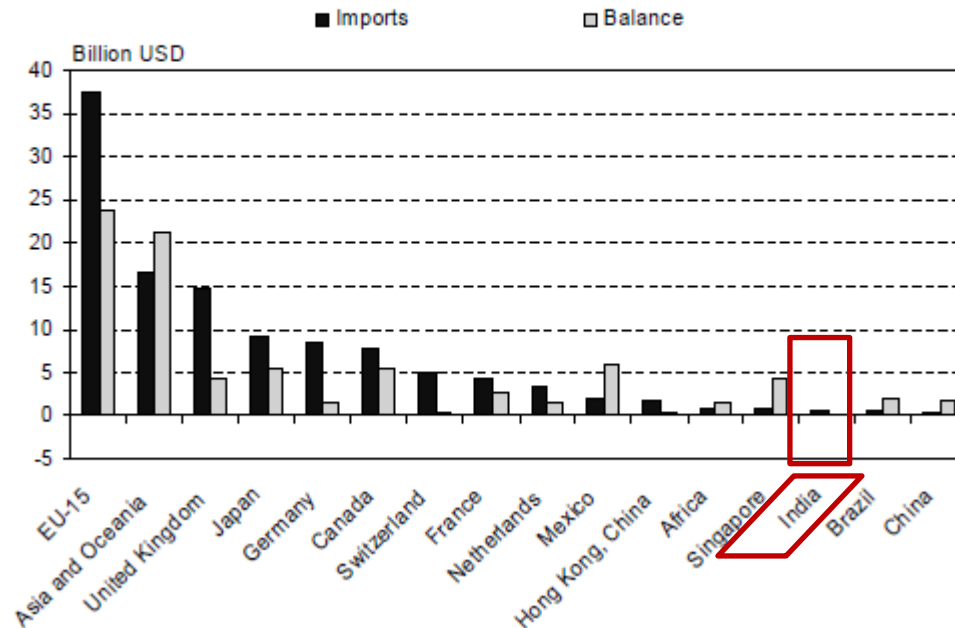
USA – Growth of employment, 1996-2000



Source: OECD, STAN database.

In Services, the US is a Net Beneficiary of Open Trade ...

Imports and trade balance for other commercial services Of the US for each partner country

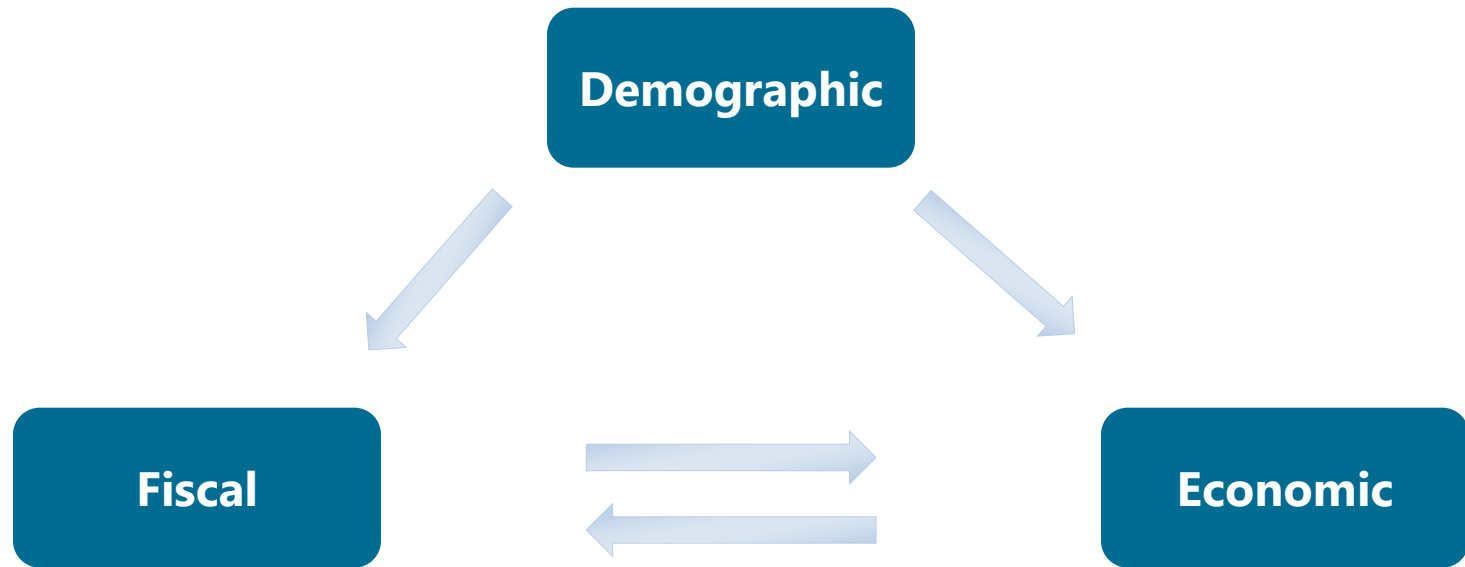


... and in dollar terms, most of the import of services is with developed countries

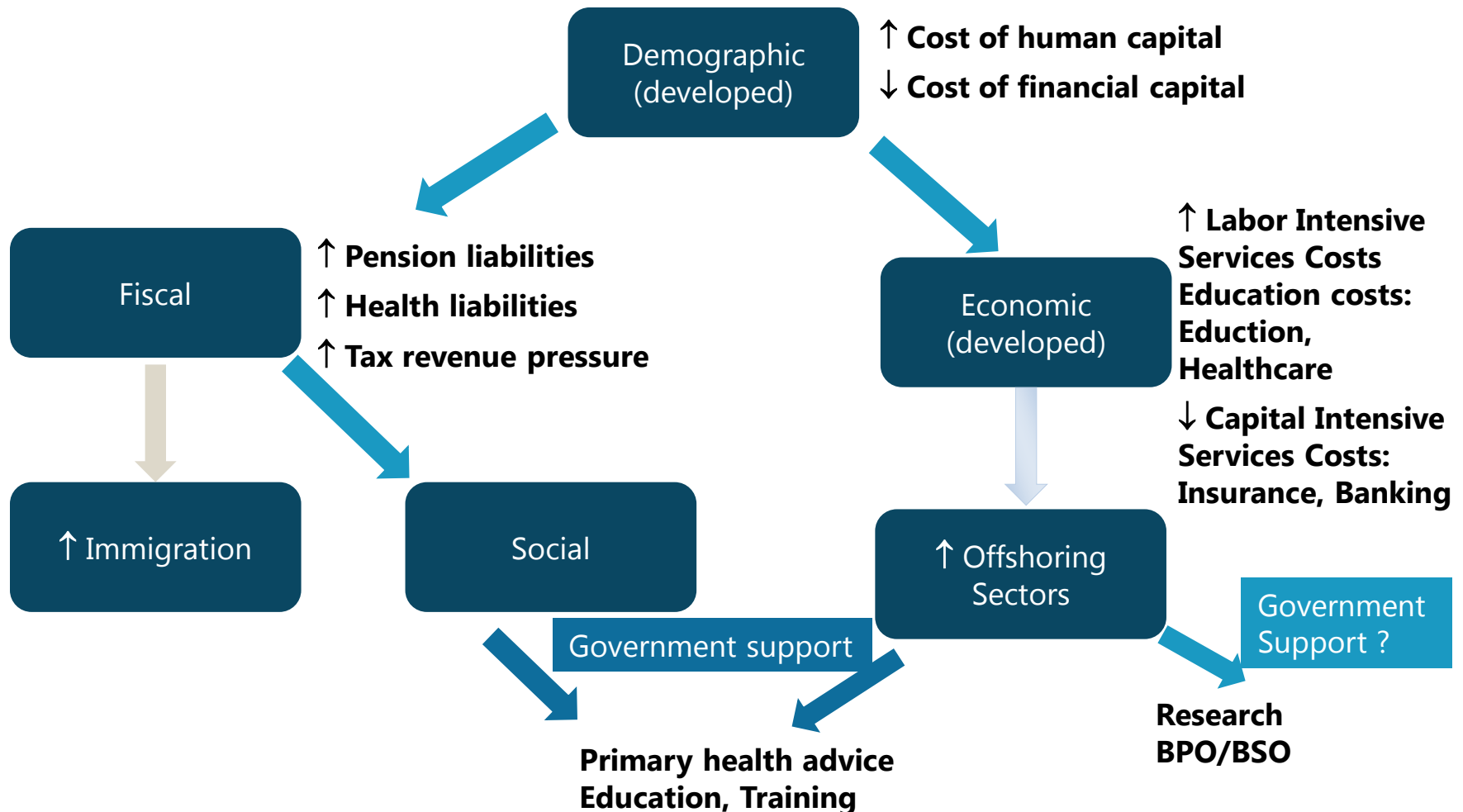
Economic Mega Trends: Conclusions

- **Offshoring is economically equivalent to importing goods or FDI**
- **Offshoring growth in *services* correlates with onshore job growth**
- **Raising productivity continuously is not easy, but it is the only preferable chance we have to service national debt**

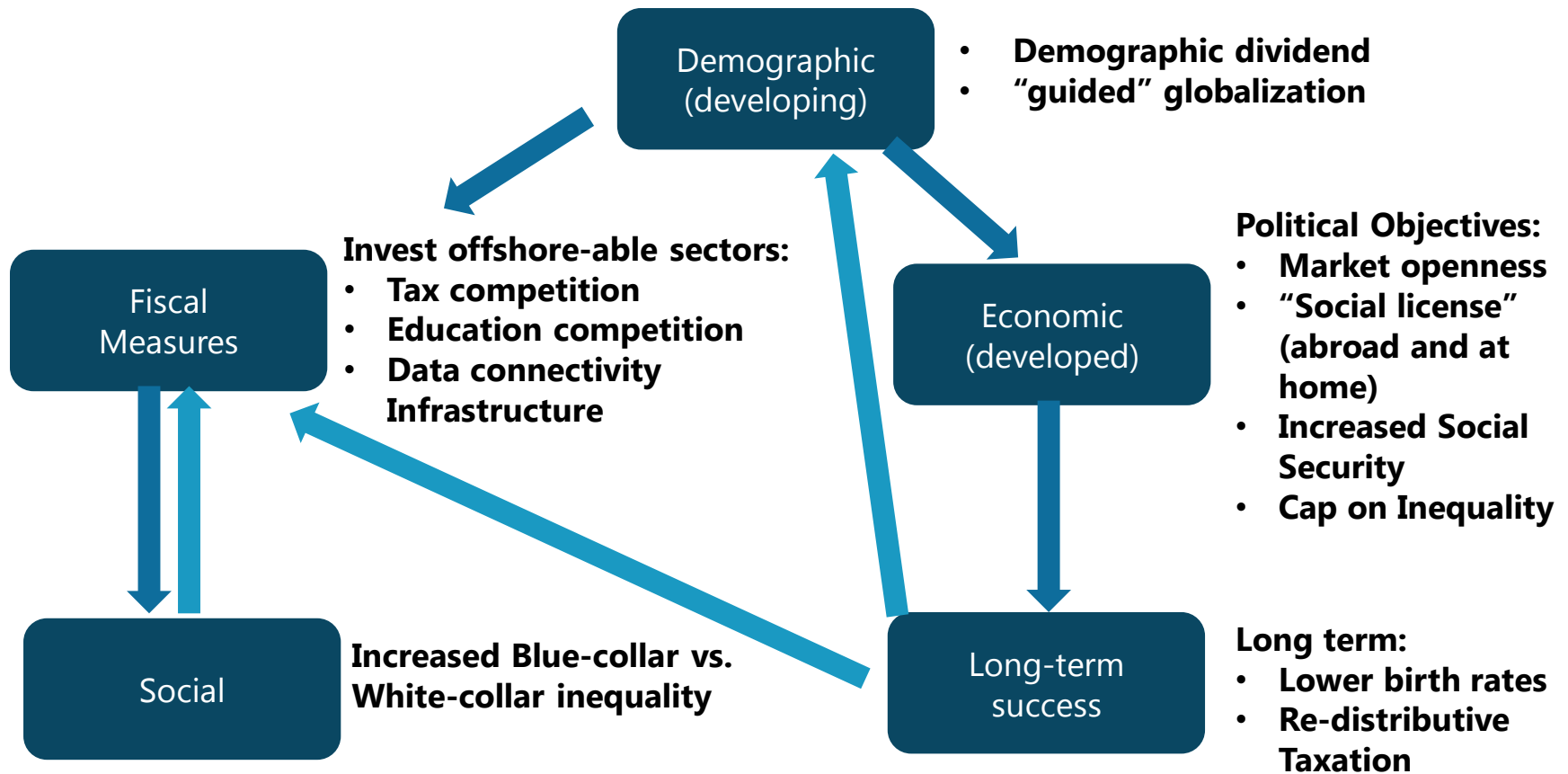
| Conclusions: How Will It Play Out?



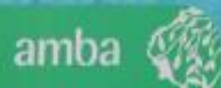
The Politics of Outsourcing Developed World



The Politics of Outsourcing Developing World

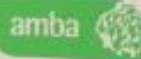






3rd Annual Capital Markets Offshoring Strategy Conference

April 11-12, 2013
Bangalore, India



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