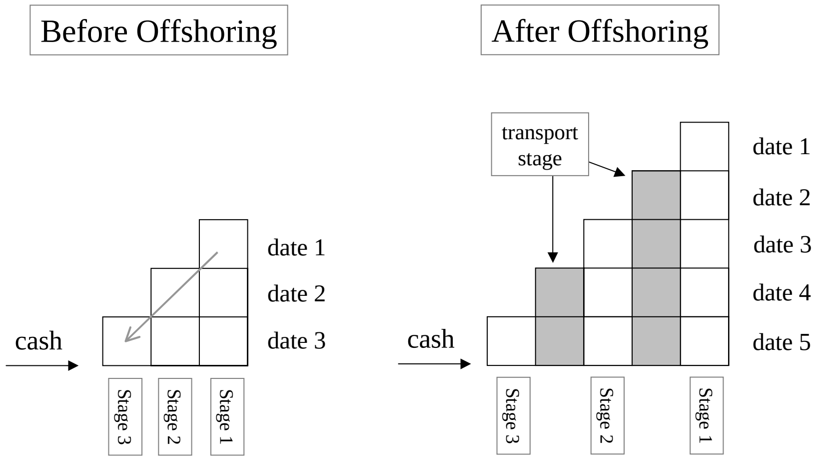

Figure 2. The left hand panel illustrates the inventories needed in a three-stage production process at one site. The right hand panel illustrates the increased inventories resulting from offshoring the second stage of production.

for transport of intermediate goods to the remote location and back. For the purpose of illustration, we suppose that the transport stage takes the same length of time as is necessary for a single production stage. Amiti and Weinstein (2011) argue that the transport stage could be as long as two months when taking account of the paperwork involved in shipping.

In Figure 2, offshoring extends the firm's production chain from three periods to five. Before the offshoring, the firm holds three vintages of inventories, reflecting the three stages of production. Under offshoring, the firm holds inventories of *five* vintages, including inventories that are in transit (grey-shaded cells).

What is clear from this example is that inventories should not simply be considered as buffer stock that enables a firm to smooth production. Tom Friedman's (2005) popular book on globalization ("The World is Flat") has a revealing quote from the chief executive officer of UPS in this respect. The UPS CEO is quoted as follows.

> "When our grandfathers owned shops, inventory was what was in the back room. Now it is a box two hours away on a package car, or it