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Einladung
11/2009

Offshoring, Wages, and Employment: Theory and Evidence

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Offshoring of US jobs is controversial. Critics fear that offshoring will lead to lost jobs and lower domestic wages at firms that offshore relative to those that do not. This paper offers theory and empirical evidence that challenge this story. The model combines heterogeneous firms with wage bargaining, in which firms endogenously select into offshoring. Given a shock that lowers offshoring costs, the theory predicts that profitability and hence domestic wages rise at offshoring firms relative to domestic wages at non-offshoring firms. Further, the model predicts that domestic employment could in fact rise at offshoring firms as expansion due to the efficiency boost could offset the loss of offshored jobs. However, the model definitely predicts that domestic employment would fall at non-offshoring firms, which lose market share and contract. Using the Mexican FDI Law of 1993 and the peso crisis in 1994 as exogenous shocks to the marginal cost of offshoring to Mexico, I proceed to test the predictions with firm-level data. The empirical findings confirm that domestic wages rise at firms likely to take advantage of the offshoring shock relative to those unlikely. Specifically, average domestic wages rise approximately 6% more during the 1993-97 period for the former set of firms compared to the latter. The results also reveal that there is no evidence of greater job loss at the former set of firms compared to the latter.

Dienstag, 16. Juni 2009

14.30 Uhr

Sitzungssaal 126a