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ScienceDirect
Labour Economics 15 (2008) 291 – 314
LABOUR ECONOMICS
www.elsevier.com/locate/econbase

The impact of international outsourcing on individual employment security: A micro-level analysis ☆

Ingo Geishecker

Georg-August-Universität Göttingen

Received 14 June 2006; received in revised form 20 June 2007; accepted 28 June 2007
Available online 7 July 2007

Abstract

The paper analyzes how international outsourcing affected individual employment security. The analysis is carried out at the micro-level, combining monthly spell data from household panel data and industry-level outsourcing measures. By utilizing micro-level data, problems such as aggregation and potential endogeneity bias, as well as crude skill approximations that regularly hamper industry level displacement studies, can be reduced considerably. The main finding is that international outsourcing significantly lowers individual employment security. Interestingly, the effect does, however, not differ between high-, medium-, and low-skilled workers but only varies with job duration.

JEL classification: F16; F23; J63; J23
Keywords: Outsourcing; Displacement; Duration analysis; Mass points

1. Introduction

International outsourcing and its alleged negative labor market effects are raising increasing public concern, especially against the backdrop of the EU's eastern enlargement. In the public debate, the predominant view appears to be that international outsourcing severely threatens domestic employment security particulary for low-skilled workers, a view supported largely by anecdotal evidence. However, in the academic literature it is far from consensual what the concrete labor market impacts of international outsourcing actually are.

☆ The author is particularly grateful to Holger Görg, Peter Egger, Stephen Jenkins, Arne Uhlendorff, Richard Upward, Katharina Wrohlich and two anonymous referees for their helpful comments. Furthermore, the author gratefully acknowledges financial support by the German Science Foundation (DFG).
E-mail address: Ingo.Geishecker@wiwi.uni-goettingen.de.

0927-5371/$ - see front matter
doi:10.1016/j.labeco.2007.06.015

This study focuses on the German labor market, which is an interesting case, being not only the largest economy in Europe, but also far more open to international trade than, for instance, the US. Furthermore, political and economic transition in the formerly communist Central and Eastern European countries during the 1990s now allows for intensive production-sharing with these economies at Germany's doorstep, with potentially sweeping implications for the German labor market.

Over recent years, a number of theoretical contributions such as Feenstra and Hanson (1996a), Arndt (1997, 1999), Deardorff (2000, 2002), Jones and Kierzkowski (2001) and Kohler (2004), to mention only a few, have highlighted the importance of international outsourcing for determining labor demand for different skill groups. However, the theoretical literature is not conclusive with regard to the labor market effects of international outsourcing. Depending on the models' assumptions and framework, international outsourcing can raise or lower relative demand for low-skilled workers.

Furthermore, all of the aforementioned models assume that labor market adjustments are achieved by sufficiently flexible wages. Although this may be justifiable in the long run, in the medium and short run, especially in a country such as Germany, wages might be fairly rigid. If this is the case, then labor market adjustments to international outsourcing have to be achieved mainly through changes in employment (see Krugman, 1995). At the same time, the aforementioned models generally abstract from adjustment costs, thus labor can move costlessly between different areas of economic activity in response to international outsourcing. However, as authors such as Davidson and Matusz (2004) convincingly show, if displaced workers experience spells of unemployment and in some cases have to be re-trained, short-run adjustment costs can consume a significant part of the overall gains from international trade. Accordingly, albeit unquestioned efficiency gains, what also matters for the welfare effects of international outsourcing is how, and how fast the labor force adjust to changing patterns of international specialisation. The focus of the present paper is therefore on the impact of international outsourcing on the short run labor markets dynamics. More specifically, the paper will address the questions of how international outsourcing affects the individual risk of leaving employment and of how the impact of outsourcing may vary with skill and employment duration.

Section 2 provides some descriptive analysis on the development of employment security, discusses the definition of international outsourcing and its measurement and gives a summary of recent developments. Section 3 gives a short overview of the previous literature on labor market effects of international outsourcing. The empirical hazard rate model is introduced in Section 4, and Section 5 describes the data set and the empirical strategy. Section 6 gives a detailed description of the empirical results for various model specifications. Section 7 summarizes and discusses the findings in relation to the literature. The general findings are that international outsourcing, defined in a strict, narrow sense, significantly raises the individual risk of leaving employment. However, there are no statistically significant differences in the impact of international outsourcing across skill groups. However, irrespective of educational attainment the outsourcing related risk of leaving employment increases with employment duration.

2. Descriptive Analysis

Table 1 shows calculations based on data from the German Socio Economic Panel (GSOEP) of how employment security of manufacturing employees has developed over the 1990s.[1] While over all individuals in 1991 the unconditional risk of leaving employment was 0.79 percent it increased

[1] The figures are calculated using monthly employment data for prime age males and females in the manufacturing industry, the sample is identical with the one used in the econometric analysis in Section 6.