

# **Offshoring and Segregation by Skill: Theory and Evidence**

## **Abstract:**

This paper examines the labor market consequences of offshoring. We use the Danish employer-employee matched data together with the newly constructed skill measures to evaluate the effect of offshoring on wages and reallocation of workers within offshorable occupations. Offshoring reduces domestic worker wages; and increases the probability of reallocation away from the high-productivity firms to the low-productivity ones. The least-skilled workers further face a greater risk of switching out to a less competitive sector. On the firm side, offshoring improves the average skill of in-house workers at a lower cost. By estimating a worker-firm matching model, we examine the mechanisms of how offshoring affects labor market inequality and further assess the quantitative importance of various competing hypotheses such as technological change and the expansion of higher education, in addition to offshoring. We find substantially different effects: technology mainly increases the inequality between firms in terms of worker skill quality and average wages, while offshoring mitigates this rising trend.

This paper is a joint work with Gueyon Kim, UCSC and Dohyeon Lee, Amazon

**Dario Pozzoli**

**Professor MSO at the Copenhagen Business School**