

# Same job, different badge

## THE RISE OF DOMESTIC OUTSOURCING ACROSS OECD COUNTRIES



November 2021

<http://www.oecd.org/future-of-work/>

### Key findings

- Many workers in OECD countries are legally employed by one firm but, in practice, work for another. For example, cleaners often physically work on the premises of one firm, but their legal employer is a third-party support services firm. Such employment arrangements are often referred to as “domestic outsourcing”.
- Domestic outsourcing of low-wage service occupations has been on the rise. On average across OECD countries, the share of guards working in the administrative and support services industry (a proxy for domestic outsourcing) increased from 38% to 54% between 1995 and 2019, while the share of cleaners employed in this industry increased from 16% to 31% over the same period.
- Even though domestic outsourcing may bring productivity gains, it has contributed to rising labour market disparities across OECD countries. In particular, domestic outsourcing is associated with earnings losses for outsourced workers in low-wage occupations.
- Policy can counteract or attenuate some of the negative consequences of domestic outsourcing on workers. For example, by ensuring that compensation and job amenities are harmonised for outsourced and in-house workers who perform comparable duties in the same workplace.

### Domestic outsourcing has increased in many OECD countries

An increasing share of workers in OECD countries are legally employed by one firm, but in practice, work for another. For example, cleaners, security guards and cafeteria staff often physically work on the premises of one firm, but their legal employer is a third-party support services firm. Often referred to as “domestic outsourcing”, this practice encompasses the contracting out of a continuing labour need from a lead firm to a contracting or outsourcing firm. In practice, these are colleagues one sees every day, but who wear a different colour badge.

Some forms of non-standard work also fall under the definition of domestic outsourcing. For example, most temporary agency work is a form of domestic outsourcing. Firms may also hire self-employed workers as a separate legal entity rather than a dependent employee. What binds these different arrangements is a legal contract between firms to meet a continuing labour demand, which replaces the direct contractual agreement between a firm and a worker as a dependent employee. For these workers, the firm that supervises and monitors their work (the lead firm) is not the same as the firm with which they have an employment contract (the outsourcing firm).

This policy brief presents recent OECD research on the incidence and consequences of domestic outsourcing of primarily low-paid occupations. There are indications that domestic outsourcing is rising across OECD countries, and that it may be particularly harmful to low-skilled workers (OECD, 2021<sup>[1]</sup>). Moving lower-skilled workers out of high-paying firms and into lower-paying outsourcing firms may lead to a deterioration in job quality, and may play an important role in rising labour market disparities.

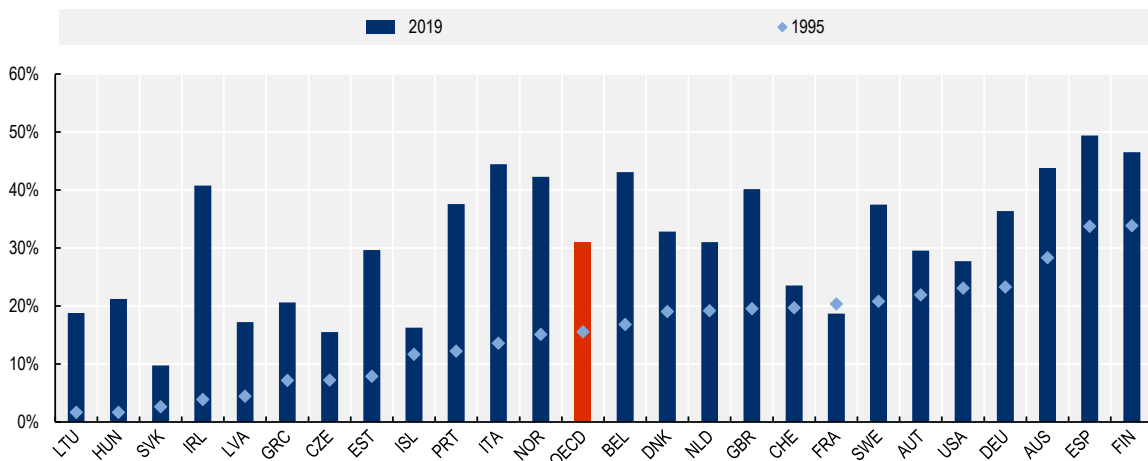
## Low-paid service workers are increasingly employed in outsourcing sectors

Certain low-skilled workers are increasingly employed in industries typically associated with domestic outsourcing. Across OECD countries where comparable data are available, cleaners have become more concentrated in the administrative and support services industry. From 1995 to 2019, the share of cleaners employed in this industry increased from 16% to 31% (Figure 1). Similarly, firms appear to have increasingly outsourced security services. On average across countries, the share of guards working in the administrative and services industry increased from 38% to 54% over this period (OECD, 2021<sup>[1]</sup>).

The growing share of cleaners and guards employed in the administrative and services industry is indicative of a general trend towards greater occupational segregation across firms. Researchers have documented an increased concentration of certain occupations within firms in the United States (Handwerker and Spletzer, 2016<sup>[2]</sup>), the United Kingdom (Cortes and Salvatori, 2019<sup>[3]</sup>) and France (Bergeaud et al., 2021<sup>[4]</sup>), which all point to a rise in domestic outsourcing. As lead firms contract out more of their workers, contracting firms will specialise, and all firms will display greater homogeneity of occupations.

**Figure 1. Cleaners are increasingly outsourced**

Share of cleaners in the administrative and services industry, 1995-2019



Note: Year 1995 refers to 1996 for Hungary, to 1997 for the Czech Republic, Estonia, Finland and Sweden, to 1998 for Latvia, Lithuania and the Slovak Republic and to 2001 for Australia. Year 2019 refers to 2018 for Norway. For additional details see OECD (2021).

Source: National sources. See: OECD (2021), "The rise of domestic outsourcing and its implications for low-pay occupations", in OECD Employment Outlook 2021: Navigating the COVID-19 Crisis and Recovery, <https://doi.org/10.1787/937ad5bc-en>.

## Domestic outsourcing could bring some benefits, but it lowers job quality

Firms turn to secondary outsourcing firms for two main reasons: raising productivity and reducing labour costs.

### **Outsourcing may boost productivity, but the evidence is thin**

Firms may use domestic outsourcing to take advantage of economies of scale and the expertise of the contracting firm. Firms may be too small to efficiently employ a cleaner or cafeteria worker on a continuing

basis. Even larger firms that have demand for numerous employees in support roles – e.g. a full canteen staff – can benefit from the specialised knowledge and organisational practices of an outsourcing firm (Abraham and Taylor, 1996<sup>[5]</sup>). In addition, the expertise of the third-party outsourcing firm may give them superior knowledge of the labour market for support roles, resulting in higher quality workers being hired at lower cost, due to reduced hiring frictions. The economies of scale and expertise of outsourcing firms can result in higher productivity.

Despite these theoretical benefits, there is little peer-reviewed research on the productivity gains associated with domestic outsourcing, and no clear consensus. An earlier literature using aggregate data sources found that outsourcing could actually reduce productivity. More recent research using high-quality administrative datasets and employing more sophisticated empirical strategies does tend to find productivity gains. However, the jury is still out (see OECD (2021<sup>[1]</sup>) for a summary).

### ***Outsourced workers tend to earn less than their in-house peers***

Firms may outsource the work of support roles and even core functions to reduce labour costs. The incentive to do so might be particularly strong for firms covered by collective bargaining agreements. In countries with firm-level bargaining, outsourcing work from a unionised lead firm to an outsourcing firm likely implies a loss of collective bargaining coverage for affected workers. For countries with sector-level bargaining, similar arguments apply. The administrative and support services sector (or generally the sector of the outsourcing firm) may be covered by a sector agreement that allows for reduced wages and benefits compared to the sector of the lead firm, or even no agreement at all.

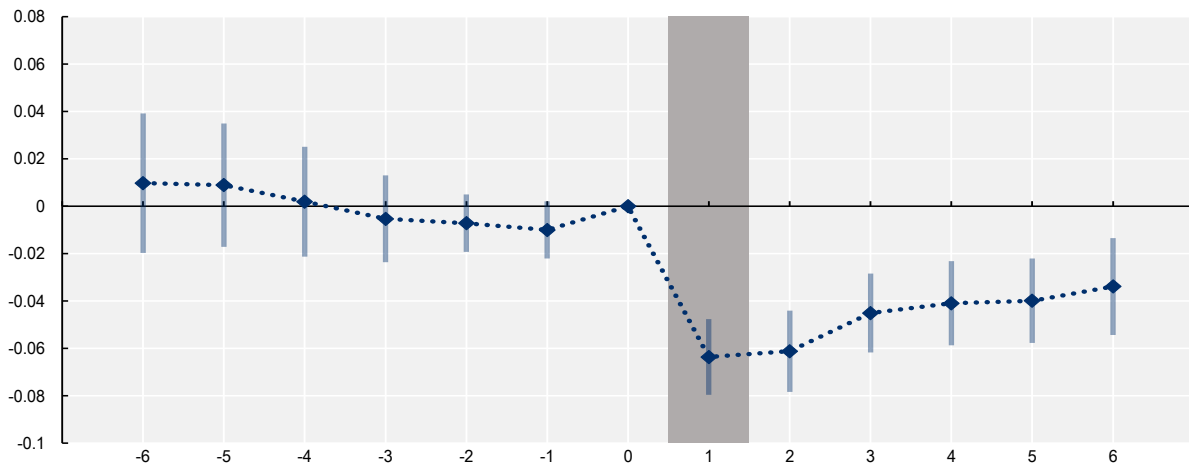
More generally, outsourcing allows high-pay firms to exclude some workers from firm rents. Certain firms or industries are exceptionally profitable. Workers employed by these firms generally have access to the excess rents produced by these firms, which manifests itself in higher wages and benefits than would prevail in an average firm in a given industry based upon the workers' characteristics (Abowd, Kramarz and Margolis, 1999<sup>[6]</sup>; Card, Heining and Kline, 2013<sup>[7]</sup>). Workers within a firm tend to have a sense of equity among their peers. Outsourcing workers to secondary employers (even if they remain at the lead firm's physical location) may lead to reduced earnings for outsourced workers as they no longer share in these rents.

Research recently published by the OECD finds earnings reductions for low-skilled workers when they are outsourced. Using administrative data from France, the researchers are able to identify workers in low-skill occupations who move to outsourcing firms and compare them to similar workers who move to non-outsourcing firms (Bergeaud et al., 2021<sup>[4]</sup>). Outsourced workers suffer an earnings penalty of around 5% which persists for many years after the outsourcing event (Figure 2).

The results found in France are similar to those found in other OECD countries. Research using German administrative data finds that outsourcing leads to wage declines of up to 10% (Goldschmidt and Schmieder, 2017<sup>[8]</sup>). OECD (2021<sup>[1]</sup>) finds similar results, with outsourced workers shifting down the wage distribution in European OECD countries, the United States and Australia. This confirms earlier results from the United States (Dube and Kaplan, 2010<sup>[9]</sup>).

**Figure 2. Change in wages of outsourced workers before and after an outsourcing event**

Low-skilled workers in France subjected to outsourcing event, 1997-2007



Note: This figure shows regression coefficients and confidence intervals at  $\pm 2$  standard errors from a dynamics event study where the dependent variables are the log hourly wage of workers being outsourced from the establishment at time  $t$ , and the regressors are dummies for the number of years before/after the establishment experiences an outsourcing event as well as control variables. Shaded area denotes the year of the mobility which is associated with noisy measures of work duration.

Source: Bergeaud et al. (2021), "Technological change and domestic outsourcing", *OECD Social, Employment and Migration Working Papers*, No. 264, OECD Publishing, Paris, <https://dx.doi.org/10.1787/e3b226da-en>.

## Policy responses and knowledge gaps

Domestic outsourcing has received relatively little attention from policy makers, which may be partly due to the fact that the concept has been difficult to measure. Only in recent years have researchers been able to better document the incidence and implications of domestic outsourcing. Having better information about the nature and the scale of domestic outsourcing may spur renewed interest from policy makers to help realise the potential productivity benefits, while protecting outsourced workers from lower wages and working conditions.

One policy area concerns the terms of employment when employees shift from one firm to another. For example, under an EU directive, when employees are moved from one firm to another due to a transfer, merger, divestiture or takeover, there is a legal requirement to maintain the pay, working conditions and collective agreements of the affected workers (EU Council Directive, 2001<sub>[10]</sub>). Whether this EU directive is applicable in the case of employee transfers while outsourcing, and how long the maintenance of employment conditions lasts in practice, is an open question and often depends on whether the outsourcing event qualifies as a transfer. In practice, an emerging empirical literature suggests that pay levels do not remain at their previous levels for workers in outsourced jobs (at least not for very long), even in EU countries.

A second policy area that merits further examination concerns the labour laws that determine who is an employer and what responsibilities the various employing entities have towards workers. This becomes particularly challenging when there are three parties involved. For example, with many collective bargaining agreements, it is not always clear which agreement applies to workers in outsourced jobs – the agreement covering the lead firm, or that of the outsourcing firm (if there is one)? The temporary agency sector could serve as an example here. In a number of OECD countries, the collective agreement that applies to temporary agency workers is the one with the most favourable provisions for the worker (OECD, 2014<sub>[11]</sub>).

Another option is for sector or national collective agreements to consider certain inter-industry occupational wages, particularly for occupations found in many industries. Australia, for example, has a form of wage regulation via the “Modern Awards” system, which is a combination of occupation- and industry-based wage floors (OECD, 2019<sub>[12]</sub>). This might prevent outsourcing decisions that bring no productivity improvement but are made purely with the aim of exploiting different wage levels for the same occupations in different industries.

Finally, better data collection to identify the incidence and diversity of tripartite employment relationships is paramount. Currently, statistical agencies make some effort to identify temporary work agency employment, and some types of self-employment. Better data collection in more easily accessible sources (labour force surveys, for example) would help to confirm the extent of domestic outsourcing in a broader set of industries and occupations. Questions that aim to uncover whether the usual place of work is different from the legal employer would help to that effect.

The OECD is continuing to advance research and policy work on the ways domestic outsourcing is shaping labour markets. At the most basic level, this entails better data collection to document the incidence of domestic outsourcing. In addition, the OECD is interested in a deeper understanding of how labour market policies interact with domestic outsourcing including collective bargaining and employment protection legislation. For further information, please see contact details below.

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