Outsourcing, Insourcing, and Changes in Inequality*

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Abstract

The fissuring of production, as through outsourcing, is frequently cited as a driver of changing inequality, but past research has mostly focused on narrow examples of it rather than comprehensively measuring the importance of this channel. We advance this literature by developing a novel algorithm to calculate average pay within a supply chain, regardless of how firm boundaries may split up that production. Using employer-employee matched data combined with firm-to-firm sales data in Chile between 2005 and 2024, we find that changing between-firm inequality is explained not by changes *within* supply chains (as expected if firms reorganize production through outsourcing), but rather by changes *between* supply chains (as expected if there are changes in the complementarity of production functions). Past research suggests that outsourcing leads to wage drops; we replicate this result, but reconcile it with our variance decomposition by showing that insourcing, which is rarely studied, is approximately as common as outsourcing and has roughly equal and opposite effects on pay.

JEL codes: F16, J31, J62

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