

The Effects of Labor Outsourcing in Pakistan

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Abstract

This study discusses the implications of labor outsourcing on Pakistan's labor market. It analyzes the effect on wages and employment at different education levels and seeks to understand who tends to benefit from this phenomenon. Using data from the Pakistan Labor Force Survey, this investigation concludes that although outsourcing brings economy-wide benefits, it does not come without redistributive downsides. Due to outsourcing, there is a widening of the wage gap in industries such as textiles and manufacturing in which the required skill is low. Certain groups of people, specifically people with an advanced skill set, will gain more from outsourcing than people with professional abilities.

Keywords: Outsourcing, Labor, Inflation, IT professionals, Globalization, Unemployment

1. Introduction

Outsourcing is a process by which companies and countries alike hire external organizations or individuals to complete tasks for them. This is done in an effort to leverage lower costs and specialized skills, which may be more prevalent in some countries than others. Many nations outsource labor to Pakistan, principally the United States, China, and Canada. According to Global Sourcing Brief. (2025, May 2), outsourcing to Pakistan can largely be credited to its large population and cheap labor.

Outsourcing remains particularly important to Pakistan due to the many jobs it creates. It has allowed various small and medium-sized businesses to grow rapidly as the nation experiences significant economic growth, particularly in fields such as IT and textiles. Depending on which sector accelerates further, outsourcing can have a meaningful impact on the country's wage inequality. This paper seeks to answer the following question: how did outsourcing to Pakistan affect labor and wage inequality across the economy? The response to this is principally focused on the country since 1990.

Figure 1 is an illustration of real hourly wage changes across different skill levels in Pakistan. When considering outsourcing in Pakistan, it is important to look at wage changes, as it provides us insight into how the labor market is transforming due to the effects of outsourcing. It shows that high-skilled jobs showed real gains in wages in the first half of the 2010s, whereas low-skilled jobs indicated very little real wage gains. This translated to an increase in wage inequality. In the second half of the decade, the situation flipped, with low-skilled jobs showing much higher real wage growth compared to high-skilled jobs, displaying a decrease in wage inequality.

Today, in textiles alone – Pakistan's largest industrial sector – many people are provided with work through

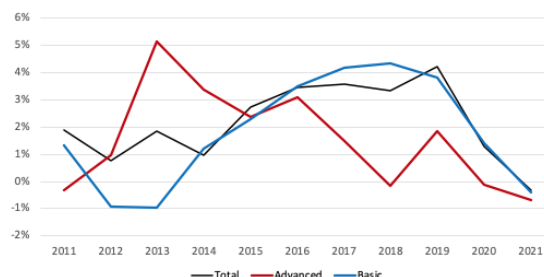


Figure 1. Real Hourly Wages for Different Skill Levels (International Labor Organization).

outsourcing as is mentioned in Ali, I. (2024). This is due to low labor costs and the high production of cotton in Pakistan. Outsourcing can have major advantages, especially for developing countries, helping to boost their economy and provide more jobs. These are some of the major benefits of outsourcing labor from countries such as Pakistan, India, Bangladesh, the Philippines, Nepal and Indonesia. The IT sector is another area within Pakistan that has seen significant growth due to outsourcing. It has also led to improvements such as technological infrastructure development, along with increased access to new equipment and skill acquisition, with digital phenomena such as AI being introduced to the country. According to the Pakistan Software Export Board. (2025, January 19). With rapidly expanding numbers of IT professionals, Pakistan has become one of the world's most sought-after destinations for outsourcing. Due to its burgeoning IT industry, Pakistan has seen momentous economic progress.

For the developing countries that execute the outsourced work, there are many benefits. First, and most notably, outsourcing provides a flow of income, often in foreign currencies, allowing countries to boost their revenue and additionally, their foreign reserves. This helps stabilize the economy of developing countries, attracting more foreign investment as a result. Secondly, there is an increase in employment and disposable income, greatly benefiting the quality of people's lives. Thirdly, outsourcing increases the skill set of a country and improves development, along with increased knowledge acquisition, when multinational corporations bring their technologies into such developing nations. These organisations also provide sophisticated manufacturing and management concepts. This gives developing countries the chance to grow and expand their local industries with the new knowledge obtained. Finally, the creation and development of new industries, such as IT, as previously mentioned, have allowed young entrepreneurs to start their own successful businesses. This can in large part be attributed to the expertise learned from companies that have outsourced to their nation. This is also spoken about in International Labor Markets. (n.d.).

While outsourcing brings many benefits to both developed and developing nations, there are downsides to the practice. Only some people from certain industries receive the advantages created by outsourcing. One major concern in developing countries is the widening of the wage gap and increased wage inequality, as outsourcing might benefit mostly well-educated people working in specific industries. This paper will analyze the extent of the impact this has produced. The effects of outsourcing have transformed the Pakistani economy in both positive and negative ways. While it has brought benefits such as jobs and the transfer of both technology and skills, it has also widened the wage gap in Pakistan, leading to wage disparity becoming a major problem. It has also brought about a loss of low-skilled jobs in developed countries, as many companies have outsourced to other nations where labor is cheaper.

The remainder of the paper is structured as follows: section 2 reviews the literature, section 3 reviews the recent history of outsourcing in Pakistan, section 4 discusses the data, section 5 analyzes the effect of outsourcing on wage inequality, and section 6 concludes the study.

2. Literature Review

Outsourcing describes the process by which work is contracted out from one country to another, mostly from developed to developing nations. The practice reshapes economies by shifting the demand for labor in developed and developing countries. The demand for labor in certain industries in developed nations and economies is outsourced to developing nations where labor is cheaper. The impacts on wage and income inequality follow from the standard textbook model of labor markets, according to Borjas, G. J. (2019). Thus, the market dictates what the wages will ultimately be, without influence from the workers or employers.

In a similar vein, Feenstra and Hanson (1997) argue that outsourcing has profound impacts on labor markets by changing the demand for different types of labor, especially in high-income developed countries, such as the United States, that are outsourcing to developing nations, such as Pakistan. To this extent, their argument follows Borjas's findings. They go on to discuss some of the associated problems, arguing that in developed countries, outsourcing reduces the already-low demand for unskilled workers, as the tasks these workers used to perform were shifted to countries where wages were lower, so that companies could save money on their labor-intensive tasks. Outsourcing has led to a growing wage gap between high- and low-skilled workers in developed nations. Furthermore, as identified by Smith and Hallock (2021), outsourcing can cause not only wage disparity but also significant job losses in HICs. Feenstra and Hanson (1997) also look at the changes and trends of the labor market in developing nations to which

labor is outsourced. For example, in Mexico, the study revealed that there is increased demand for middle-skilled labor. In their 1996 analysis, Feenstra and Hanson investigated the impact of international trade and outsourcing on wage inequality within the U.S, reaching a similar conclusion to Hummels et al., which will be addressed later in the literature review. The authors explore how, during the 1990s, the U.S. experienced a notable increase in wage inequality between skilled and unskilled labor. The interpretation shows that a large part of the rise in demand for skilled labor and the loss of unskilled labor is due to U.S. companies outsourcing to other nations.

Taking a broader outlook, Goldberg and Pavnik (2003) provide an overview of the economic impacts of outsourcing, focusing on the effects on the labor markets in both developed and developing nations. The paper discusses how both globalization and outsourcing in particular have reshaped the global economy and have led to significant changes in labor demand and economic structure around the world. Mobility of workers to meet outsourcing demand is an additional central thesis of their argument. The study makes note of the importance of outsourcing on developed nations and argues that this has led to a dangerous trend of workforce relocation, especially in areas where tasks are labor-intensive and expensive, such as in developed nations, to where it is cheaper. This leads to unskilled workers in developed nations having limited opportunities where they already had very few, leading to the widening of the wealth gap in HICs. This point of view follows the argument put forward by Feenstra and Hanson (1997) regarding labour demand in developed nations. Along with this, in developing nations, there has been a rapid increase of outsourced jobs, which is communally seen in labor-intensive occupations such as manufacturing. The paper asserts that although outsourcing has had major benefits, it has not come without its downsides and has led to significant changes in labor demand and economic structure around the world.

Whilst Borjas, G. J. (2019) discusses the labor market, he also addresses areas like unemployment and inequalities in the market, to name a couple of examples. The study explores how the decisions of policymakers affect the labor market. It also focuses on the effects of unions and the role they play in providing equilibrium to the market. In this way, Borjas offers a fresh perspective on the topic, taking industrial action and its consequences into consideration. Continuing on the theme of wage difference laid out by Feenstra and Hanson, Hummels et al. (2014) addresses the wage effects of offshoring and discusses the impact of offshore activities. It examines wages using sources such as Danish matched worker-firm data. According to this source, by relocating their production abroad, firms changed the wages of their employees, regardless of skill level. Furthermore, high-skilled workers experienced a gain in their wages due to an increase in demand for advanced tasks, while low-skilled workers faced a decline in their wages. This highlights how outsourcing contributes to wage disparity. The text also emphasises the effects of outsourcing on global wage inequality and changes in supply chains. This is important when examining the worldwide effects of outsourcing and its impact on the entire economy. The analysis provides crucial insights into the global market and the effect it has on the world's economy, along with how it reshapes wage structures and the consequential impact on supply chains.

The timeline of this paper is focused principally on developments since the 1990s, following the trajectory of globalisation. Harrison and McMillan (2011) examine the relationship between global corporations and outsourcing during this period. Along with this, it also discusses employment trends in the U.S. Using detailed data sets, the text analyzes whether outsourcing abroad results in job losses domestically in the U.S. or what other effects it has within national industries. The findings reveal that the effects of outsourcing vary significantly by industry and type. For example, when tasks that require low skill are outsourced, employment declines for less-skilled workers. This to some extent agrees with findings made by Feenstra and Hanson (1997). However, when high-skilled tasks are outsourced, it can actually lead to the creation of jobs. The research is vital when talking about the loss of jobs due to outsourcing and highlights the varied results depending on the type of outsourcing.

Hummels et al. (2014) posited that low-skilled workers can suffer as a result of outsourcing and this argument is also reflected in Smith, and Hallock (2021). This study focuses specifically on the impacts of trade on the labor market; when the trade between one nation and another nation rises, it will be advantageous for some workers. The workers who are affected by low skills are the workers who are left to suffer. In the United States alone, 300,000 employees are expected to lose their jobs every year as a result of outsourcing. Among these, the majority are the new generation of the labor force, particularly the lower-skill category. This results in demands on governments to offer more opportunities for such lower-skilled workers to find employment. Nonetheless, this source is limited in its usefulness as it only addresses the downsides of outsourcing and discusses none of the many benefits.

Much has been written in this paper regarding the globalised impacts of outsourcing, yet Jamal (2009) analyses the problem of income distribution, specifically in Pakistan. The analysis finds that increasing income disparities exist, and are rising even further because of labor outsourcing, and he addresses the socioeconomic aspects of it. However, it also mentions the perceived root of the problem. For instance, structural reasons, resources and opportunities within and without labor markets. Factors such as employment in urban areas or in rural areas, education levels and employment requirements for individuals are also raised. Therefore, it is very useful literature with a view to understanding the phenomenon of outsourcing in Pakistan and the consequences that it has on the economy, in terms of the rise in income disparity and what could have been causative factors. Whilst Feenstra and Hanson (1997) give a crucial insight into wage gaps in developed nations as a result of outsourcing, Jamal (2009) argues that similar impacts are being felt in developing nations such as Pakistan.

Complementing Pakistan-centric observations made by Jamal (2009), Burki, Memon and Mir (2015) discuss inequality in the labor sector in Pakistan, focusing on the socioeconomic, regional, and structural issues faced in the country. The author highlights how inequality continues to grow due to unequal access to resources such as education and employment opportunities. The text underscores the rural-urban divide in Pakistan and gender disparity. Furthermore, their research identifies the importance of effective public policies to break the cycle of wage inequality, such as increasing access to education and implementing poverty eradication programmes alongside better infrastructure. The issues highlighted in this paper, along with the proposed solutions, make it consequential for discussions on the widening wage gap in Pakistan. Whilst examining the topic through a slightly different lens, the authors agree with Jamal (2009) that there is great wage disparity in Pakistan, although not specifically attributing this to outsourcing.

Grossman and Rossi-Hansberg (2008) discuss the impact of outsourcing on labor markets and how it can lead to a loss of wages and other downsides for low-skilled workers in high-income countries due to increased competition from cheap labor from developing countries. For this reason, their findings are closely aligned with the interpretations put forward by Hummels et al., where this theme was addressed with specific reference to the US. The paper examines policies and their impact on outsourcing and urges governments to address the inequality which outsourcing leads to while investing in education and skill development, allowing workers to adapt to changing labor markets and help reduce the impacts which outsourcing has on domestic workers.

3. History of Outsourcing's Impact on Pakistan (1990-2021)

Over the years, outsourcing has led to momentous changes in the Pakistani economy, with the country positioning itself as a key player in the global outsourcing industry. Pakistan has seen exponential growth in both the fields of IT and textiles. The outsourcing shift, specifically to Pakistan, is driven by Pakistan's large workforce (which demonstrates a wide variety of skills), while also being significantly cheaper in comparison to other nations. As businesses around the world are beginning to increasingly rely on outsourcing to improve efficiency, this allows Pakistan to be pivotal when it comes to providing labor to other nations. Pakistan first began major outsourcing in the 1990s, which is in line with globalization and the development of the internet. The internet provided new opportunities for businesses to connect with labor markets in other parts of the world such as Pakistan. The textile industry, which was for a long time the cornerstone of Pakistan's economy, became one of the first beneficiaries of outsourcing as international companies sought out production in Pakistan due to its high-quality, inexpensive labor.

As a result of this, the textile industry continued its rapid growth in Pakistan. According to Iqbal et al. (2023) the textile industry in Pakistan has led to employment of over 15 million people, or 40 percent of the recognized workforce, while contributing 60 percent of Pakistan's exports and generating around \$19 billion, or 8.5 percent of Pakistan's GDP. The outsourcing industry continues to grow, proving its consequence and continued reliability to the Pakistani economy over the years.

Another industry that grew significantly with the help of outsourcing is Pakistan's IT industry. Pakistan has emerged as a significant destination for outsourcing IT services due to its large workforce of skilled individuals, low labor costs, and improving technologies, making it reliable for external tech giants, which is especially important to Pakistan in an ever-digitizing age.

IT outsourcing in Pakistan began in the 2000s, following a wider global trend. The internet has rapidly emerged and demand has increased for cheap IT facilities, which Pakistan was able to fulfil and well-suited to provide. At this time, the Pakistani IT industry surpassed Hong Kong's and experienced the following; a dramatic relative growth, which also included freelancing services, where IT specialists can offer IT support on sites such as Fiverr to a global market. The IT industry has a workforce of over one million, growing fast and offering a nationally significant form of employment. It yields \$2.8 billion per annum, making up 0.77 percent of Pakistan's GDP. Haq, R. (2009).

4. Methodology

Data on employment and wages comes from the Labor Force Survey (LFS), conducted by the Pakistan Bureau of Statistics (PBS) and was retrieved from the International Labor Organization's (ILO) website.

The LFS dataset is annual and ranges from 2006 to 2021. However, it misses the following years: 2012, 2016, 2017 and 2020. The missing years are filled in by a simple linear interpolation of wage, employment and labor force data.

Data on nominal wages is reported in Pakistan's local currency (Pakistani rupees) and deflated using Pakistan's Consumer Price Index (CPI), also published by the PBS, to obtain a measure of real wages.

This paper considers aggregate labor market data as well as a breakdown by education level and geographical location. The education levels considered are advanced (tertiary degree or higher), basic (primary degree), and less than basic (no primary degree or illiterate). The geographical areas considered are nationwide, urban and rural.

This study follows a historical approach in analyzing labor market data, using economic theory to suggest relationships between main labor market indicators. A more exact inference of causality is left for further empirical studies on this topic.

5. Analysis

The data shown in the Figure 2 displays unemployment rates in Pakistan from 2006-2021 across different skill levels. The unemployment rate allows us to gauge how outsourcing affects different industries. It shows that the rate for unemployment relating to people who have advanced education is especially high, with a peak of 16.5 percent in mid 2015. This could be due to outsourcing in industries where advanced labor is not required. In basic education, it remained substantially lower, most likely due to outsourcing creating jobs where a low level of education is required, such as in textiles.

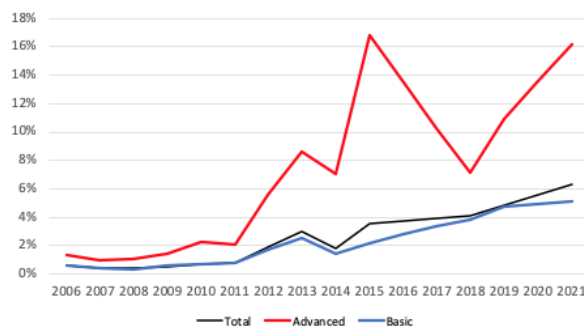


Figure 2. Unemployment Rates for Different Skill Levels (International Labor Organization).

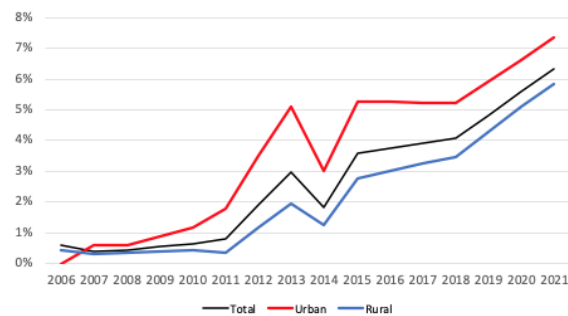


Figure 3. Unemployment rates in different geographical areas (International Labor Organization).

If crossreferenced with the other figures provided by Feenstra and Hanson (1996) on income inequality, it is clear that when the demand for skilled labor rises, the unemployment rate diminishes and wages increase due to outsourcing in sectors such as IT. Simultaneously, a similar trend can be detected in basic education; when demand increases, so do wages and the unemployment rate decreases due to outsourcing industries which require a low level of education. Again, this is best exemplified when considering textiles.

This helps explain what can be deduced from Figure 1; those who had advanced education made more gains in the first half of the graph, which contributed to an increase in wage inequality in Pakistan, whereas those who had

lower education had more gains in the second part of the graph, therefore leading to a decrease in wage inequality.

In conclusion, it is plain that outsourcing can either increase or decrease wage inequality depending on what sector is being outsourced and the type of outsourcing which is being carried out.

In the data provided, it is clear how unemployment varies between both urban and rural areas of Pakistan. Unemployment is higher in urban areas than in their rural counterparts, possibly due to jobs in rural areas being tied to agriculture. This is an industry which wasn't affected by the economic transformation which took place in Pakistan over the last couple of decades; where that rapid change took place in urban areas, there was a higher rate of unemployment. We can connect this to a shift in the economic landscape of Pakistan where both high and low-skilled workers are required due to the new complex tasks brought in by outsourcing especially in the rapidly growing IT industry. These highly skilled workers are most commonly found in urban areas; there are few to none in rural areas of Pakistan. This is referenced in Jamal (2009) in the context of the urban versus rural divide in Pakistan.

Connecting this graph to another figure in the paper, it's possible to detect that in rural areas the unemployment rate did not go up due to a scarcity of advanced educated workers, providing more opportunities for the rural basic educated labor force and subsequently less unemployment in the rural setting compared to the urban setting. Therefore, outsourcing has different impacts upon the economic landscape of Pakistan as is clear from urban wages versus rural wages in Pakistan.

6. Conclusion

In conclusion, this paper highlights both the benefits and downsides of outsourcing. These effects are felt across the globe in developed and developing countries alike. The broader implications of wage inequality and how it affects nations on either side of the economic spectrum are significant. During the course of this project, various sources of data were used and compiled into graphs. The information was focused on Pakistan.

In terms of the benefits that outsourcing brings to developing nations, when large companies outsource work to these countries, it leads to more development and investment in foreign capital, which is particularly vital for developing economies. Furthermore, the technology and skills that these companies implement allow developing nations to create and grow their own domestic industries alongside international outsourcing.

The figures in Section 5 attest to the vast impact which outsourcing plays on the Pakistani economy. Whether considering the impact it has on various levels of education or that which it has on urban versus rural sectors and their employment, it emphasises outsourcing's significance in the country.

However, the downsides for developing nations include a widening of wage inequality due to the effects of outsourcing not being evenly distributed across regions. This leads to socioeconomic issues, particularly for people in rural areas, as seen in Figure 3, who lack opportunities compared to those in urban centers where outsourcing is more prevalent. Furthermore, depending on the type of outsourced work being done, there may be disparities based on education levels. For instance, if outsourcing focuses on low-skill tasks, individuals with less education benefit more. Conversely, when it involves tasks requiring higher skill and education, the benefits tend to be reaped by more educated individuals.

When examining the benefits for developed nations, it's intelligible that high-intensity and labor-intensive tasks are outsourced to developing nations, leading to cheaper products for consumers and enabling companies to grow and expand over time. However, the downsides for developed countries include a lack of job opportunities for people previously employed in low-skill positions, as these roles are often transferred to lower-cost regions.

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