Topic 6 – Trade and Unemployment

Prof. Ralph Ossa

Introduction

- While trade economists emphasize the effects of trade on real incomes, much of the public discussion revolves around jobs

- In our models, trade creates and destroys jobs in certain industries but we have assumed that aggregate unemployment remains fixed

- In this lecture, we will briefly explore how reasonable this assumption is in the long-run and in the short-run by looking at the emerging literature on trade and unemployment

- To date, this literature suggests that trade has no clear effect on long-run unemployment but can increase short-run unemployment in the adjustment phase

Long-run versus short-run

- As you may remember from macroeconomics, economists typically distinguish between natural and cyclical unemployment

- Natural unemployment captures the long-run trend in unemployment while cyclical unemployment captures short-run deviations from this trend

- Natural unemployment is commonly attributed to search and matching frictions (frictional unemployment) and wage rigidities (structural unemployment)

- Cyclical unemployment is usually thought to fluctuate with the business cycle, rising in recessions and falling in booms

Overview of the lecture

- Trade and unemployment in the long-run
- Trade and unemployment in the short-run
- Some context on labor market dynamics

Trade and unemployment in the long-run

- A plausible link between trade and frictional unemployment would be cross-industry variation in search and matching frictions

- Trade would then lead to a fall in frictional unemployment in countries which have a comparative advantage in low-friction industries and an increase in frictional unemployment elsewhere

- A plausible link between trade and structural unemployment would be downward wage rigidities for unskilled workers

- Trade would then increase structural unemployment in countries which would otherwise experience an increase in the skill-premium and decrease structural unemployment elsewhere

Trade and unemployment in the long-run (contd.)

- This discussion suggests that the long-run effect of trade on unemployment is ambiguous and depends on labor market institutions

- This is also the general theme of the theoretical literature on trade and long-run unemployment which has suggested numerous additional effects

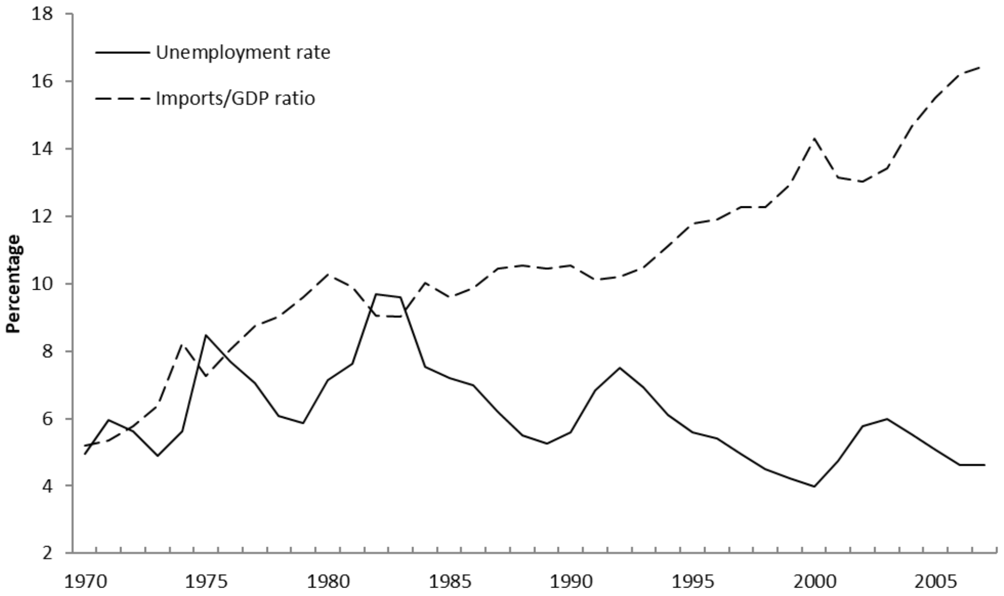
- Surprisingly, the literature has not yet produced any authoritative empirical study on trade and long-run unemployment although there are some recent attempts

- My conjecture is that trade may have contributed somewhat to structural unemployment in Europe but had little effect on long-run unemployment in the US

Universität Zürich[UZH]

Trade and unemployment in the long-run (contd.)

Civilian Labor Force and Civilian Employment in the United States, 1960-2007
Source: World Development Indicators



Unemployment and Import Penetration in the United States, 1960-2007
Source: World Development Indicators

Source: World Bank

Trade and unemployment in the short-run

- While trade liberalization is unlikely to cause cyclical unemployment, adjustment frictions should contribute to higher unemployment in the short-run

- For example, some industries expand and others contract following trade liberalization and it takes time for workers to move from the import-competing to the export oriented industries

- Recall from our discussion of the China shock in the previous lecture that such adjustment frictions appear to be surprisingly important in the US

- In particular, Autor et al (2013) find that reductions in manufacturing employment and increases in unemployment or labor force non-participation go hand in hand

Trade and unemployment in the short-run (contd.)

- This then raises the question "how short is the short-run?". An interesting perspective is provided by Trefler (2004) who studies the effects of the Canada-US Free Trade Agreement (CUSFTA) of 1989

- He finds that CUSFTA led to a 5% reduction in Canada's manufacturing employment which amounts to a loss of 100,000 jobs

- However, he also argues that these job losses were temporary in nature in the sense that they were made up by job gains in other parts of manufacturing within 10 years

- Trefler (2004) again uses a differences-in-differences methodology so that his results on level effects have to be taken with a grain of salt

Trade and unemployment in the short-run (contd.)

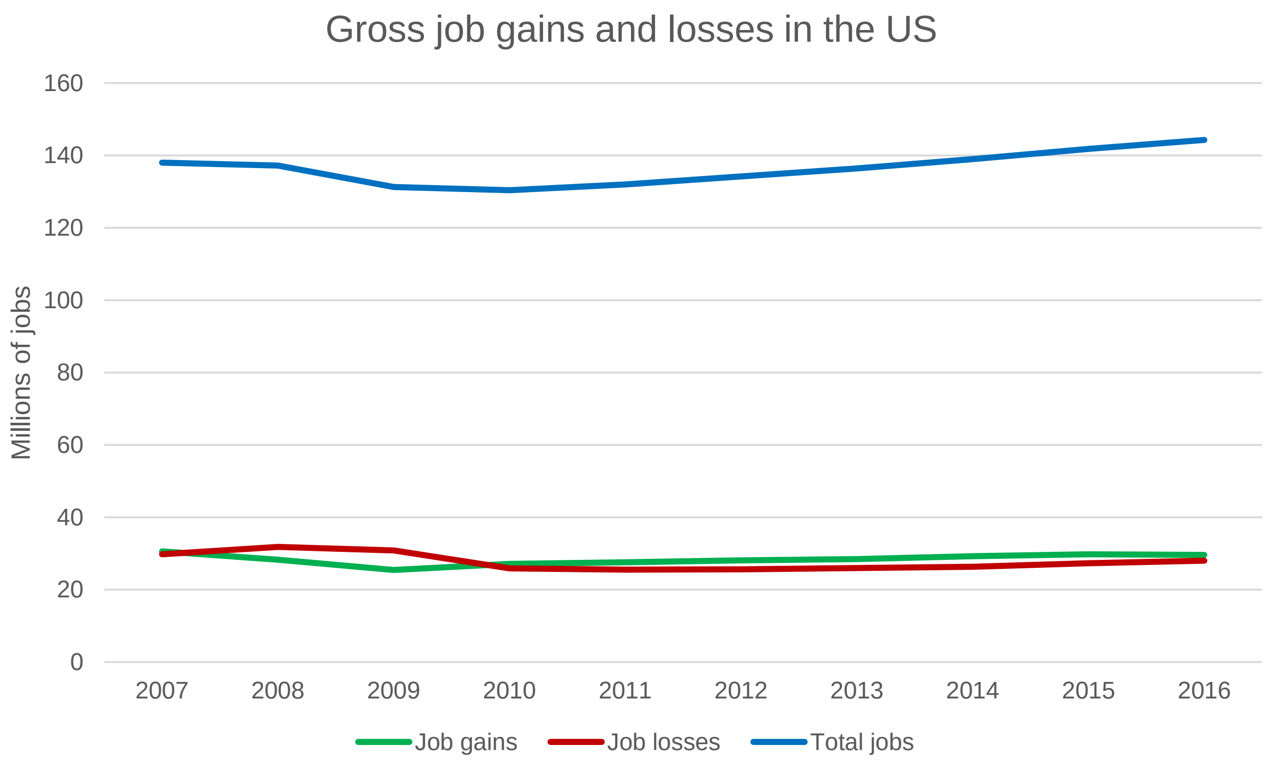
- Motivated by such evidence, some recent studies have attempted to quantify inter-sectoral mobility costs using structural models of labor and trade

- An early example is Artuc et al (2010) who use a stylized model to estimate that inter-sectoral mobility costs amount to approximately six times the average annual wage in the US

- Their estimate was then corrected downwards to approximately one to three times the average annual wage in a subsequent study by Dix-Carneiro (2014) which uses a more realistic model

- Karambourov (2009) has tried to open the black box of “mobility costs” and found that labor market regulations, specifically firing costs, play an important role

Some context on labor market dynamics



Source: Bureau of Labor Statistics

- In all of this, it is important to keep in mind that there is substantial turnover in the labor market

- For example, approximately 20% of all jobs get created and destroyed in the US every year

- This implies that almost 30 million jobs get created and destroyed in the US every year

Conclusion

- In this lecture, we took a brief look at the emerging literature on trade and unemployment

- So far, this literature suggests that trade has no clear effect on long-run unemployment but can increase short-run unemployment in the adjustment phase

- However, there is clearly a need for more research!

References

- *E. Artuc, S. Chaudhuri, and J. McLaren. 2010. "Trade Shocks and Labor Adjustment: A Structural Empirical Approach". American Economic Review*
- *D. Autor, D. Dorn, and G. Hanson. 2013. "The China Syndrome: Local Labor Market Effects of Imports Competition in the United States". American Economic Review*
- *R. Dix-Carneiro. 2014. "Trade Liberalization and Labor Market Dynamics". Econometrica*
- *G. Karambourov. 2009. "Labor Market Regulations and the Sectoral Reallocation of Workers: The Case of Trade Reforms". Review of Economic Studies*
- *D. Trefler. 2004. "The Long and Short of the Canada-US Free Trade Agreement". American Economic Review*