Trade and Labor Market Outcomes

Elhanan Helpman

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  - exporters are bigger and more productive than non-exporters

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  1. to explain unemployment in European economies, it is necessary to allow for interactions between shocks and differences in labor market institutions;
  2. changes over time in labor market institutions are important determinants of the evolution of unemployment in OECD countries.

Labor Market Rigidities

- There are substantial differences across countries in labor market rigidities

Country	Hiring	Hours	Firing	Index
United States	0	0	0	0
Uganda	0	20	0	7
United Kingdom	11	20	10	14
Japan	28	60	0	29
OECD	**27**	**45**	**27**	**33**
Mexico	33	40	40	38
Germany	33	60	40	44
Russia	33	60	40	44
Rwanda	56	60	30	49
France	67	60	40	56
Morocco	100	40	50	63
Spain	78	60	50	63
Bolivia	61	60	100	74

Source: Botero, Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2004)

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- It seeks to achieve job flexibility and employment security via active labor market policies.

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  - and what is the impact of trade on inequality and unemployment?

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- Preferences: quasi linear (marginal utility of homogeneous good constant), CES in differentiated sector (homothetic with constant relative risk aversion can be used instead).

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- Output is produced and markets clear.

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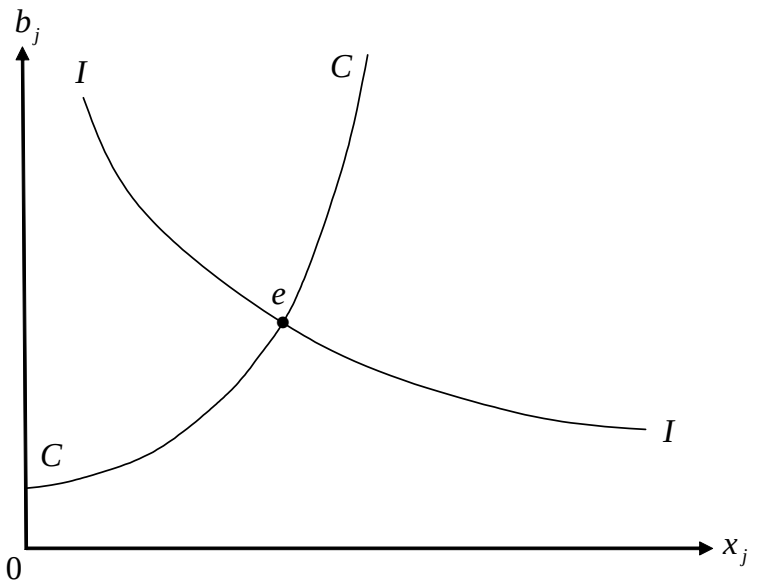
- Unemployment:

$$u = (1 - x + \sigma_f x) \frac{N}{L}.$$

Hiring Costs and Tightness in Labor market



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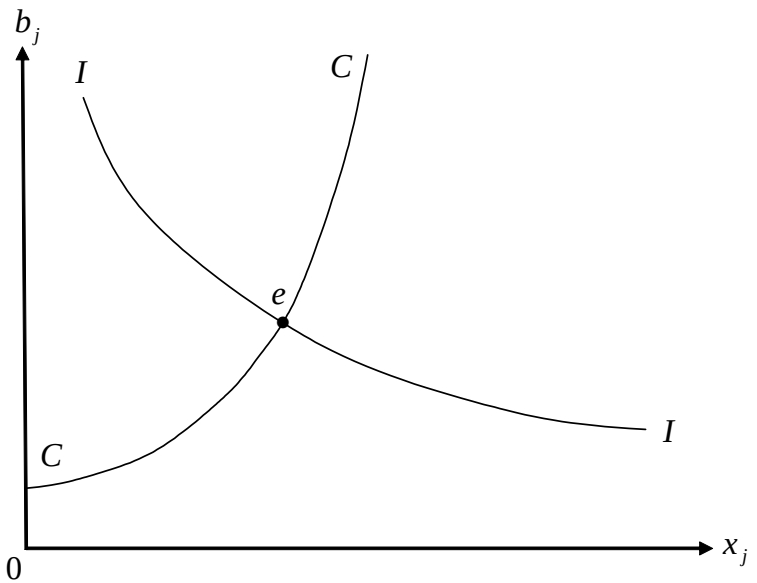

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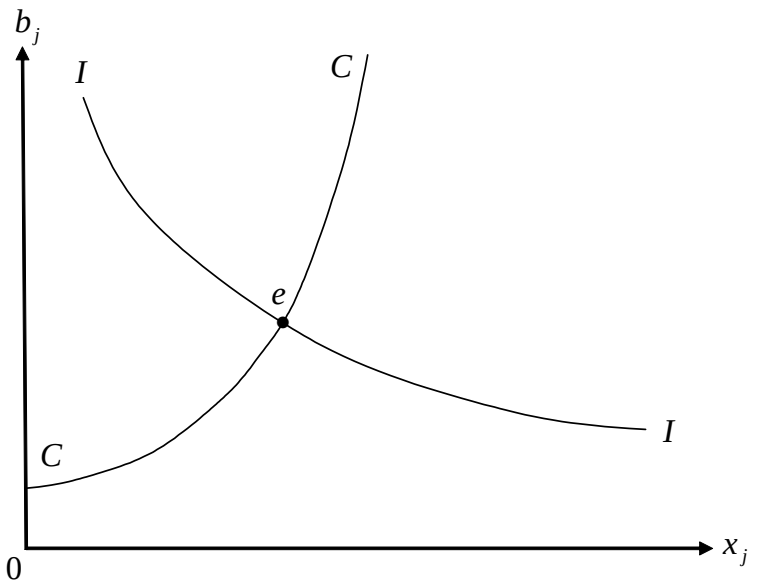

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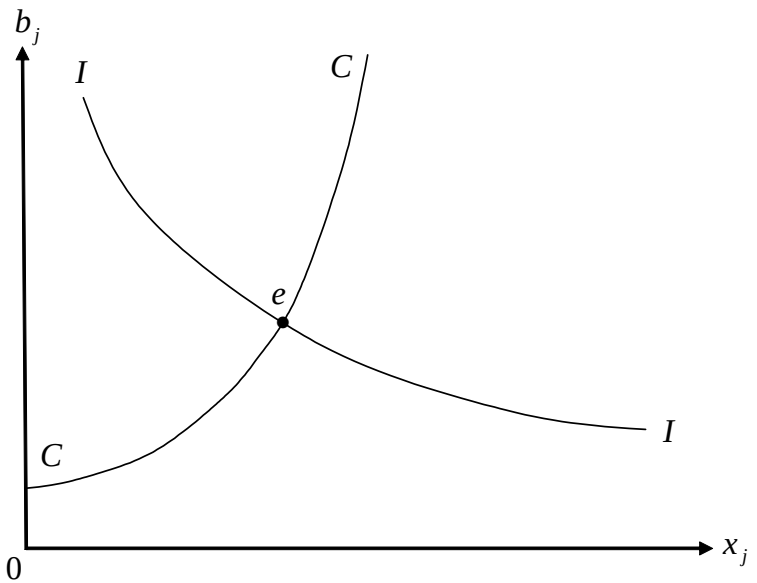

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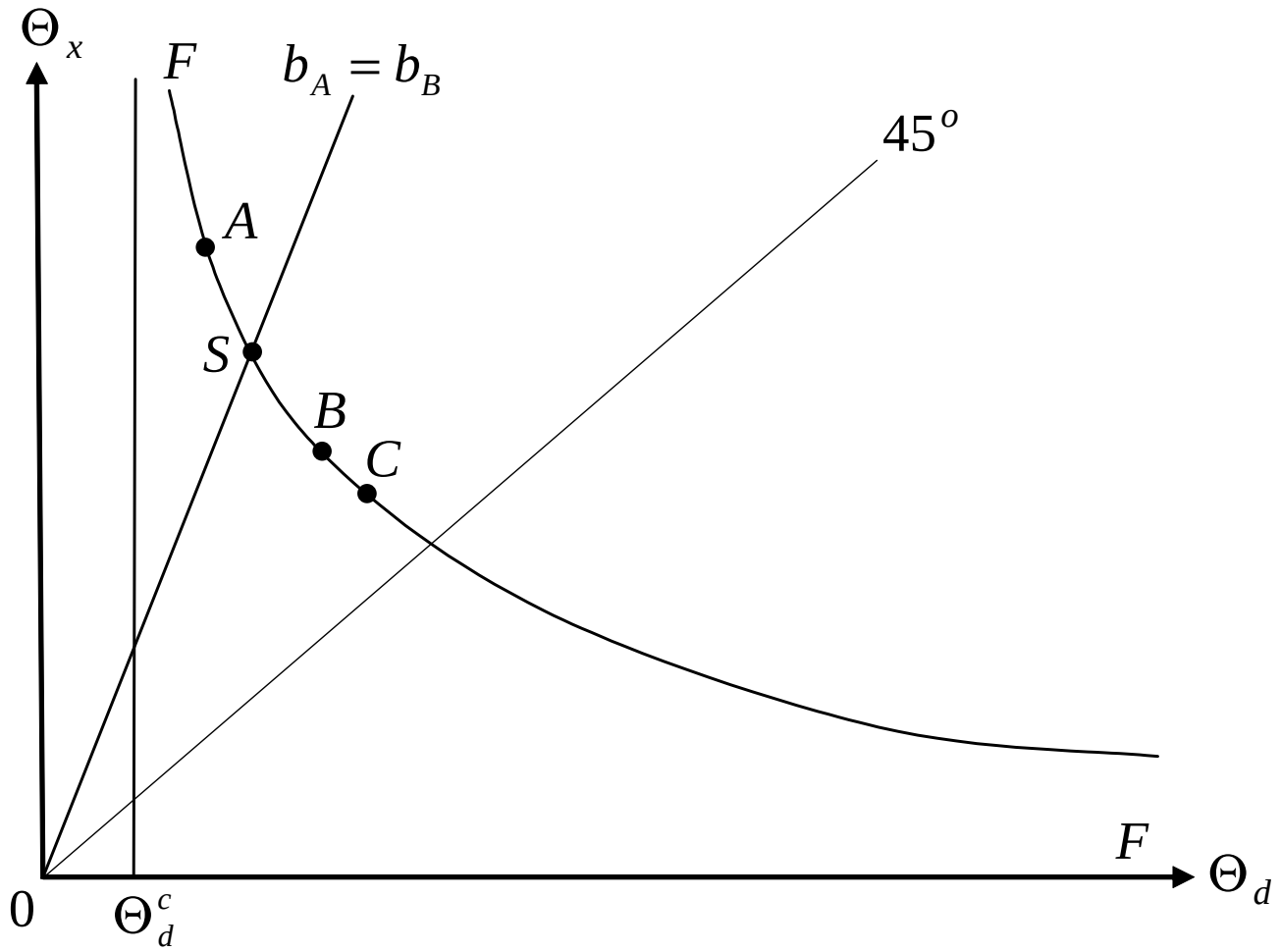
- Larger hiring costs $\Longrightarrow$ less competitive industry.

Equilibrium Cutoffs



Hiring costs affect productivity cutoffs

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  - (i) a larger fraction of differentiated-product firms export in country B; (ii) country B exports differentiated products on net and imports homogeneous goods; (iii) the share of intra-industry trade is smaller the larger is the proportional gap in hiring costs.

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  - (i) in the closed economy, TFP does not depend on the quality of labor market institutions; (ii) TFP is higher in any trade equilibrium than in autarky.
  - If in addition, productivity is distributed Pareto, then: (iii) TFP is higher in country B; (iv) an improvement in labor market institutions in country j raises TFP_j and reduces TFP of the trade partner; (v) a reduction of trade costs raises TFP in both countries.

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  - In the vicinity of a symmetric equilibrium: (iii) country B has a lower rate of unemployment if and only if the b_js are low; and (iv) an improvement in a country's labor market institutions reduces the rate of unemployment in its trade partner, yet it reduces home unemployment if and only if the b_js are low.

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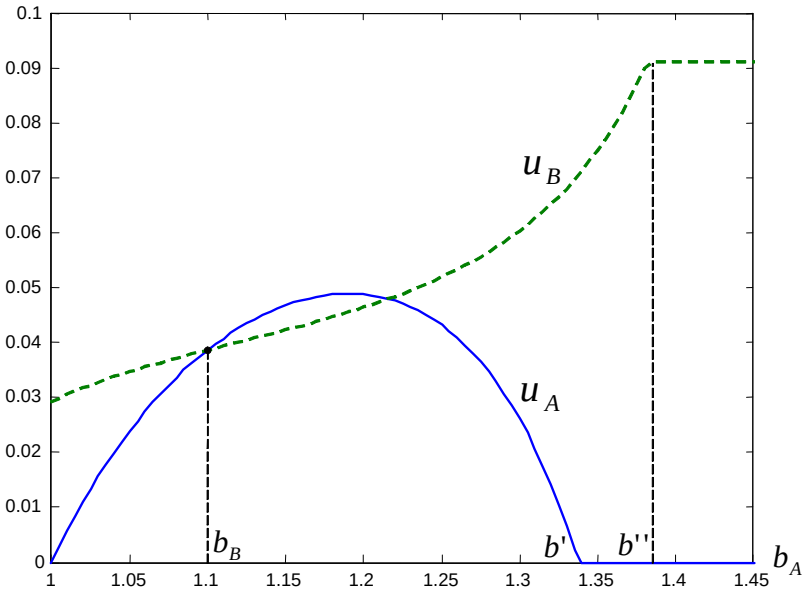
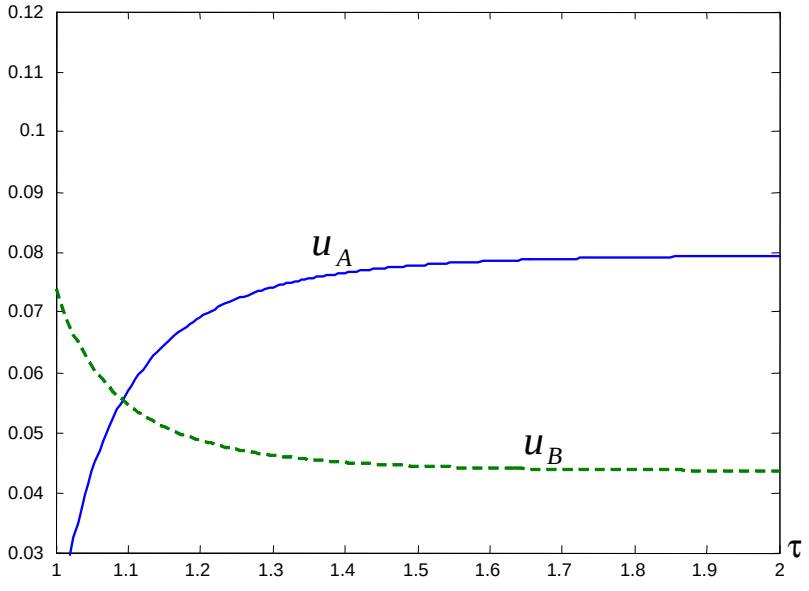
- Welfare (assuming small unemployment benefits):
  - (i) both countries gain from trade; (ii) welfare is higher in country B; (iii) an improvement in labor market institutions in one country raises its welfare and reduces the welfare of its trade partner; (iv) a simultaneous improvement in labor market institutions in both countries, with $\hat{b}_A = \hat{b}_B$, raises welfare in both of them.

Large Differences in Labor Market Frictions





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- Unemployment does not reflect welfare in the cross-section; the country with higher welfare may have higher unemployment.
- Active labor market policies that raise competitiveness (reduce b) are welfare improving with no unemployment benefits, but may reduce welfare in the presence of unemployment benefits.
- Higher severance pay or higher unemployment benefits may raise competitiveness.

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- Now assume that firm productivity and worker ability are distributed Pareto (makes closed-form solutions possible) and there is no firing and no unemployment benefits.

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- Unemployment rate:

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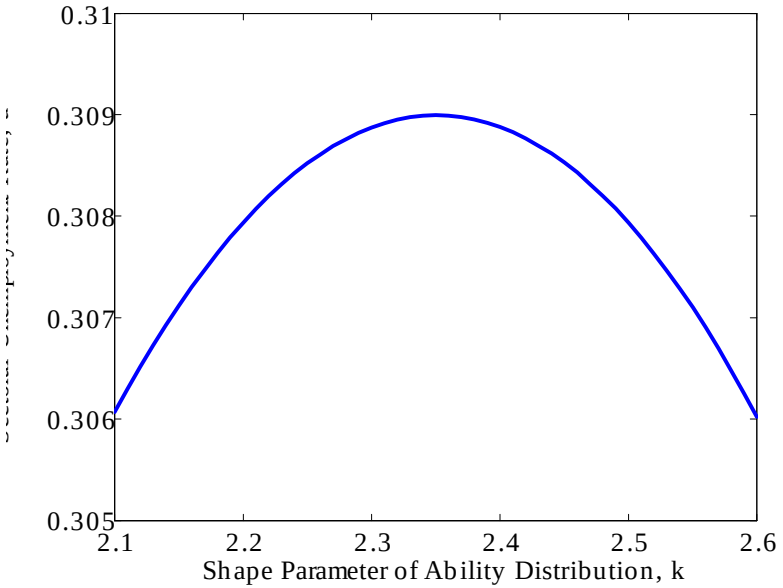

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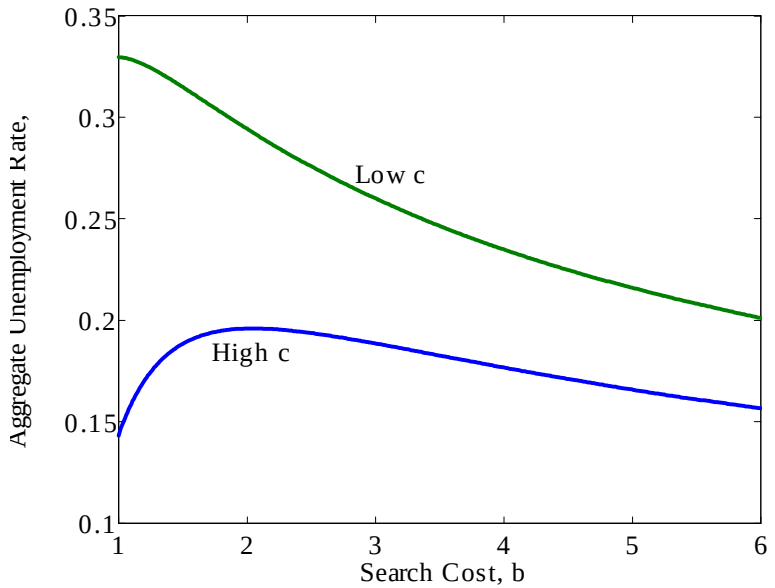
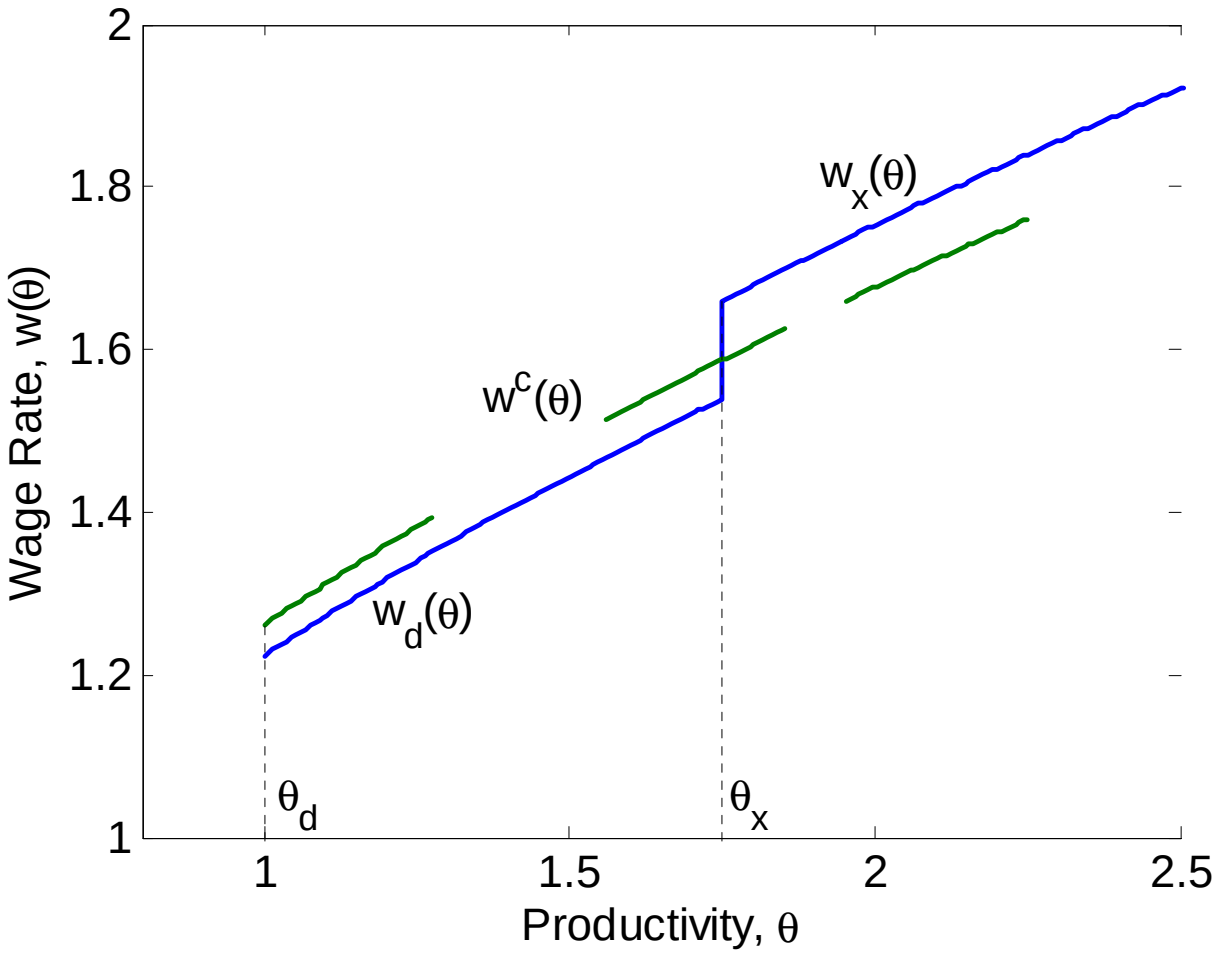


Wage Profile: Open vs Closed Economy



There is a fixed exporter fixed effect in the wage equation

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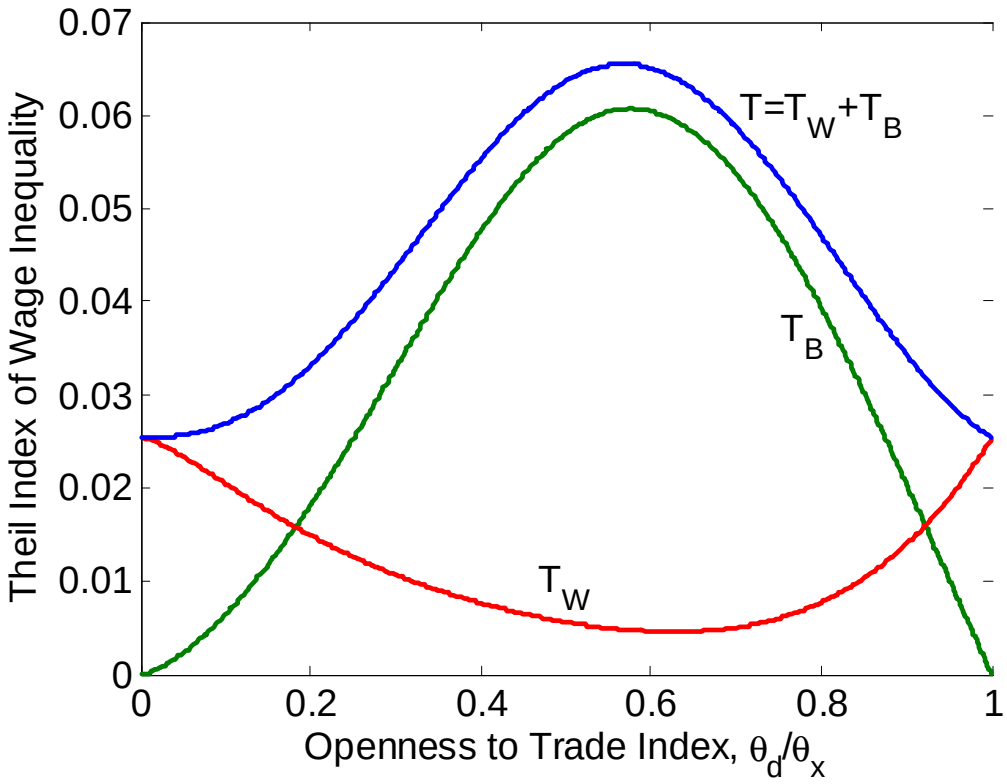

Inequality vs openness

Unemployment, Inequality and Welfare

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6. Finally, simple macro models are inadequate for assessing active labor market policies, and especially so in a world of integrated economies.