

Trade and Inequality

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Trade and Inequality in Developing Countries

- My research background:
 - Labor market responses to trade liberalization in developing countries
 - Survey on “Distributional Effects of Globalization in Developing Countries,” *Journal of Economic Literature*, Goldberg and Pavcnik (2007)
- Discussion of research on specific aspects of trade and inequality delegated to separate sessions
 - Trade, firms and employment
 - Trade and informality/job quality
 - Labor market adjustment to trade reform
 - Trade and Skill upgrading

Goal

- Trade and Inequality
 - Researchers have made big progress toward understanding the link between trade and wage inequality between educated and less educated workers in poor countries
 - Why? Some common features of recent research design
 - Identify areas for future research
- Trade and poverty

Big question: trade and increasing inequality

- Many developing countries liberalized international trade since 1980.
- The workhorse model of trade based on endowment differences across countries suggests that less educated workers in *developing* countries, should benefit from reduction of trade barriers (Krueger et al: *Trade and Employment in Developing Countries*)
 - Lower poverty
 - Lower inequality
- Yet, wage inequality between educated and less educated (skill premium) increased in many poor countries since 1980s
- This “puzzling” fact instigated a large body of research
- Success toward resolving the puzzle

Research design

- Empirical work guided by theory
 - Static link between trade policy and inequality via changes in relative prices and wages (empirically tractable)
 - NOT dynamic link through growth
 - Focus on specific channels through which trade affects income
- Micro-level data for particular countries (firms, individuals, households)
- Direct measures of trade policy/trade costs to identify the effect
 - Reductions in trade barriers induced by large-scale trade liberalizations
 - Exchange rate shocks
 - Liberalization of Foreign Direct Investment/Trade in intermediate goods
- Consider the role of other reforms and confounding factors

Explanations for increased wage inequality

- SBTC or trade-induced SBTC
- But trade based on relative endowment differences between rich and poor countries plays some role.
 - Not trade based on differences in the use of skilled labor *across* industries
 - Little reallocation of employment across industries.
 - Increase in the relative demand for educated within rather than across industries
 - Trade induces changes in relative demand for educated labor within industries
 - Factor proportions differences across stages of production Feenstra and Hanson (1997, 1999)
 - Factor proportions differences across firms within an industry Bernard and Jensen (1995, 1997)

Ongoing and Future Research: Residual wage inequality

- Most research focuses on wage differences between educated and less educated workers
- Large part of increased wage inequality attributed to inequality of wages of workers with same observable characteristics (i.e. residual wage inequality)
- Does trade contribute to changes in residual wage inequality?
 - Industry wage premium (trade matters, but magnitudes small)
 - Heterogeneity in wages across firms within an industry (session 2)
 - Driven by productivity differences across firms
 - Yeaple (2005), Kaplan and Verhoogen (2005), Verhoogen (2008), Bustos (2005), BRS (2007), Amiti and Davis (2008), Davis and Harrigan (2007), HIR (2009)
 - Unobserved worker heterogeneity

Trade and Poverty

- Higher wage inequality does not necessarily imply higher poverty
- Difficult to draw conclusions about trade and poverty
 - Studies on trade and inequality often based on data that cover individuals employed in the “formal” sector living in urban areas
 - Poor: less educated worker in formal manufacturing sector
 - Don’t capture populations most vulnerable to poverty
 - Unemployed
 - Individuals working in “informal” sector, smaller firms
 - Individuals not working for wages
 - Individuals living in rural areas

Existing research on trade and poverty

- An emerging literature examines the direct effect of trade on poverty (Porto (2004), Goldberg and Pavcnik (2007), Topalova (2005), McCaig (2008), Mitra, et. al. (2007))
- Analysis relies on household level data that overcomes some of measurement challenges
- The effect of trade on poverty depend on
 - The nature of trade reform
 - Institutional context in which reform takes place
 - Mobility constraints on individuals

Ongoing and Future Research: Trade and Poverty

- Need to better understand the underlying mechanisms
- Examine how particular phenomena that are highly correlated with poverty are affected by recent trade liberalization episodes:
 - Absolute wages (as opposed to relative wages)
 - Unemployment
 - Employment in the informal sector, small firms
 - Compliance with labor standards (minimum wage in particular)
 - Relative prices of goods consumed primarily by the poor
- The role of mobility across geographic regions/industries/firms within a country
 - Trade associated with increases in poverty in areas with high concentration of previously protected industries (Topalova (2005)) or no effects on poverty (Goldberg and Pavcnik (2007), Mitra et. al. (2007))
 - Trade associated with declines in poverty in areas benefiting from export boom (McCaig (2008))
 - What inhibits people from moving toward new economic opportunities?

Ongoing and Future Research: Trade and Poverty

- So far, my comments focused on static effects of trade on poverty via changes in employment, wages and prices
- Dynamic effects of trade on poverty via growth