Conference on Sustainable development, firm performance and competitiveness policies in small open economies , CompNet Research Network

Trade Liberalization: Winners and Losers in a Search Framework

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23 June 2020

RQ & Findings

RQ: how are the ***workers' lifetime income gains and losses from trade liberalization*** are distributed across young and old workers?

Methodology: *overlapping generations model* using a quasi-specific factor framework (Mussa, 1974)
Labor market ingredients: search and matching frictions with bargained wages; sector switching costs; and finite working life;

Novelty: Finite versus infinite life and Nash bargaining rather than competitive wage setting;
calibrating the model to match key features of the US economy, following China's accession to the PNTR status (1995), and WTO (2001) relying on PSID data (1969-2009).

Key findings: impact of trade liberalization on lifetime income:

1. **Younger workers have larger losses** than older ones and new entrants, because they have lower outside option (lower future wages and more work years remaining)
2. ***In the transition***: workers in the import exposed sector suffer losses (2% to 5%) while workers in other sectors see gains (0.5%- 1%)
3. ***In the long-run:*** overall there is 1% gain while a small part of workers (3%) suffer losses (1%), as they switch to low-service sectors (low ability workers that previously would have entered the import-exposed manufacturing sector).

Debate & Intuition

Debate: young versus old workers

- higher impact on older workers due to high ***sector switching costs*** (Artuc, 2009, Dix-Carneiro, 2014)
- higher impact on younger workers due to lower ***firm-specific tenor*** (PSID evidence and in Autor et al., 2014)

Intuition:

Trade liberalization results in a fall in tariffs, that will also result in reducing value of the goods in the import-exposed manufacturing sector.

- ***Direct impact:*** lower current wages given the lower value of output (symmetric on all age groups)
- ***Indirect impact:*** current period wages are determined by bargaining over the value of current and future output (future output suffer stronger drop if more work-years remaining, i.e younger workers).
- the outside options falls by more for younger workers: firms have relatively more (workers less) power in the wage negotiation as they know that the sector now has a lower job prospects.

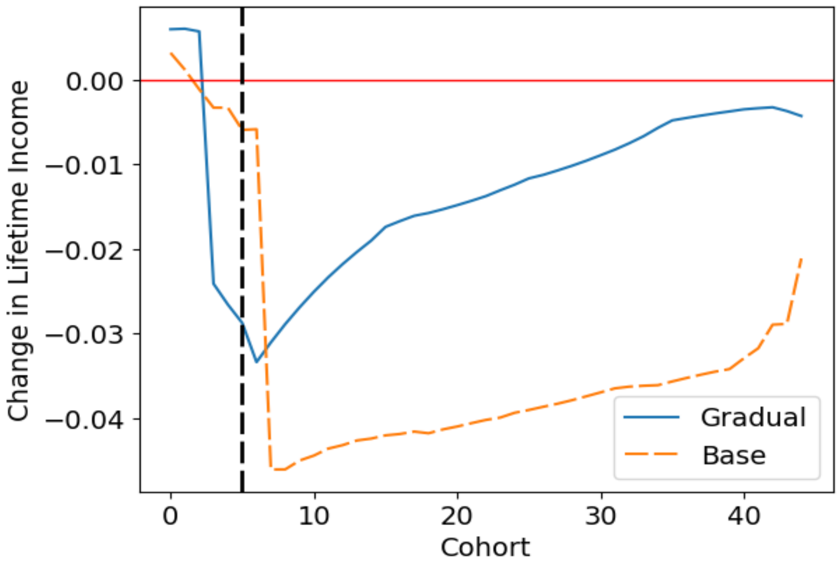
- *But this is only if workers have no other options (or changes are too costly)and stay in import-affected manufacturing firms.*

Policy implications: gradual trade liberalization and/or earlier announcement

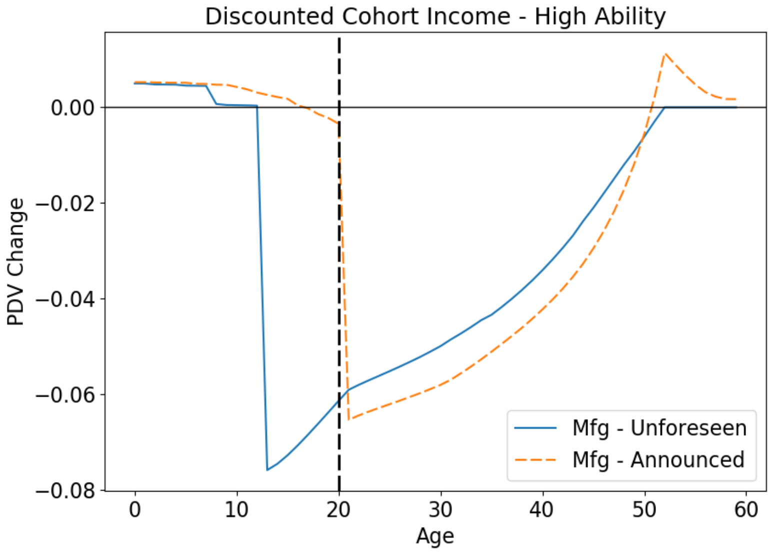
Gradual liberalisation: path of restrictions that limit imports for the 15 years to 20% of the final steady state import amount, then for the next 10 years up to 40% and for another 5 years up to 60% - *result in lower losses by nearly one third*!

Earlier announcement: induces workers that are entering the economy to go to the other sectors since and they will not face losses when the trade shock happens, while those that made their sector entry decision prior to the announcement period have larger losses than in the baseline scenario.

Gradual liberalisation versus baseline



Earlier announcement



Suggestions

Lifetime income measure including pension savings: summing up the wage income and unemployment benefits in the entire time period. Special case of USA: pension funds investing in their own company's stock depend strongly on the company's value (affected negatively by trade liberalisation if it is import-exposed).

Sector switching costs also age-dependent. Real-life experience would suggest that switching costs should be easier and less costly for younger workers (both from demand and supply perspective).

Sector switching costs depending on framework conditions: more developed economies/region (offering education, training, performing labour market services, labour mobility) should allow for easer and less costly switch to more productive firms (positive overall impact) while smaller, undeveloped economies/region with significant import pressure might have limited options to switch and consequently they suffer higher income losses.

Earlier announcement should enhance sector switch: even those that already made their sector entry decision, still can switch before direct negative impact on their wages. The model should take in consideration that the cost of sector switch is lower during the announcement period than after shock.

Possible follow-up: impact of reintroducing trade tariffs, or reversal of trade liberalisation? Analyzing both import-affected and exporting sectors.