

Inequality and Unemployment in a Global Economy*

Elhanan Helpman
Harvard University and CIFAR

Oleg Itskhoki
Harvard University

Stephen Redding
LSE and Yale School of Management

October 17, 2008

Abstract

This paper develops a new framework for examining the distributional consequences of trade liberalization that is consistent with increasing inequality in every country, growth in residual wage inequality, rising unemployment, and reallocation within and between industries. While the opening of trade yields welfare gains, unemployment and inequality within sectors are higher in the trade equilibrium than in the closed economy. In the open economy changes in trade openness have nonmonotonic effects on unemployment and inequality within sectors. As aggregate unemployment and inequality have within- and between-sector components, changes in sector composition following the opening of trade complicate its impact on aggregate unemployment and inequality. However, when countries are nearly symmetric, the sectoral composition effects reinforce the within-sector effects, and both aggregate inequality and aggregate unemployment rise with trade liberalization.

*Work on this paper started when Redding was a Visiting Professor at Harvard University. Helpman thanks the National Science Foundation for financial support. Redding thanks the Centre for Economic Performance at the London School of Economics for financial support. We are grateful to Pol Antràs, Gilles Duranton, Gene Grossman, Esteban Rossi-Hansberg, Dan Trefler, and seminar participants at LSE, Toronto and Yale for helpful comments. The usual disclaimer applies.