Inequality and Unemployment in a Global Economy*

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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.

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