

## Empirical Project 7: Trade and the Gap between Wages of Skilled and Unskilled Workers

An obvious concern with trade flows is its impact on wages, especially whether it can lead to changes in wages of different types of workers. More precisely, does trade affect wage inequality between skilled and unskilled workers? The following Jan. 11 article in the Financial Times highlights how strong such concerns are in the United States and how it can affect the popular view about whether free trade is generally a good thing or not:

*"The widening gap between the rich and middle-class Americans is undermining political support for free trade in the US, the president of the Federal Reserve Bank of New York, warned on Thursday.*

*Tim Geithner told the Council on Foreign Relations that the "political challenge" of sustaining support for further global economic integration "may be the most important economic challenge of our time".*

*He cited as big political problems the "long-term increase in income inequality", the "slow pace of growth in real wages for the middle quintiles of the population", increased volatility in income and the greater exposure of families to risks involved in financing retirement and healthcare.*

*Echoing views expressed by Larry Summers, his former boss as Treasury secretary in the Clinton administration, Mr Geithner said it was "not enough to explain that globalisation is inevitable" and protectionist policies were self-defeating.*

*Better education and an improved safety net were a "necessary part of the solution to this challenge". But, he warned, "these reforms will have a long fuse and they may not yield the hoped-for increase in support".*

**ASSIGNMENT: Address the following questions with data analysis, media quotes, and/or other evidence to back up your answers. As with all of these assignments, make sure to appropriately document your sources of information.**

**A)** If one thinks of a Heckscher-Ohlin world where there are two factors of production, skilled and unskilled labor, what would the Stolper-Samuelson Theorem predict should happen to the "wage gap" between skilled and unskilled workers for developed countries as they open up to trade? What about for less-developed countries?

**B)** Read William Cline's summary of the evidence on the "wage gap" between skilled and unskilled workers that the academic economics literature has found

(<http://www.econ.yale.edu/alumni/reunion99/cline.htm>)

and address the following questions:

**i)** Has the "wage gap" been growing or declining over time? Cline's data/graph is fairly dated. Construct a more recent measure of the wage gap (2000-2006) using data on wages by occupations from this U.S. Bureau of Labor Statistics website:

<http://www.bls.gov/webapps/legacy/cpswktab3.htm>

(You'll have to make a judgement about which occupations look relatively skilled and which ones relatively unskilled)

**ii)** What are other possible explanations for the changes in the U.S. "wage gap" and what seems to be the general answer about how much trade has played a role in these changes?

**C)** Now look at a recent working paper by Owen and Yu that graphs the wage gap for China in

their Figure 1 on page 25:

[http://academics.hamilton.edu/economics/home/Workpap/03\\_04.pdf](http://academics.hamilton.edu/economics/home/Workpap/03_04.pdf)

What is happening with the "wage gap" in China over time? How does this fit with the Stolper-Samuelson predictions you discuss in part A above? What does this say about trade versus other factors as the primary source of the "wage gap" changes we are seeing across the world?

**RESTRICTIONS:** Can have a maximum of three students handing in a joint project. Report cannot be longer than 4 pages of text (double-spaced) with an extra page allowed for charts and graphs.