Labor market effects of trade liberalization

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Economists have long touted the benefits of free trade between individuals and countries as a pillar of human progress and a foundational principle of global society. While most experts argue that free trade is beneficial overall, others are increasingly concerned about the immediate costs to workers in import-competing industries who could lose their jobs. Trade-related unrest in the labor market often leads people to support nationalistic political parties that are hostile to trade and immigration. This turmoil has inspired some economists to closely investigate the costs and benefits of freer trade relations and the impact reductions in tariffs (taxes on imports) and other trade barriers have on workers across geographic regions.

A new study on the Brazilian labor market found that workers in regions with industries facing increased competition from imports experienced a steady decrease in earnings over time in comparison to other regions. The authors found that wages and employment growth in these regions lagged behind other areas that were less affected by tariff reductions for 15 years, which is significantly longer than previous research suggests. The study, led by researchers from Duke University and Carnegie Mellon University, is forthcoming in the *American Economic Review*.

"Our research shows that the costs and benefits of freer trade are unevenly distributed across different regions and that the differences grow for decades," said Rafael Dix-Carneiro of Duke University. "As public sentiment has turned against globalization, it is important to understand how the costs and benefits of freer trade are shared among different workers."

To further understand this dynamic, Dix-Carneiro and Brian Kovak of Carnegie Mellon University's Heinz College of Information Systems and Public Policy, looked at how the labor market in Brazil responded to large decreases in tariffs in the 25 years after tariffs were reduced in the early 1990s. Average tariffs fell from 30.5 percent to 12.8 percent, which disproportionally affected some areas more than others depending on the variety of industries in a particular region. For example, Rio de Janeiro faced a large tariff reduction due to its apparel manufacturing and food processing industries, while Mata Grande, which mainly produces agricultural goods, actually experienced a small increase in tariffs. The authors found that workers in regions facing larger decreases in tariffs saw their earnings and employment growth diminish for 15 years following the change in trade policy. These differences increased over time, with labor markets consisting of more import competing industries falling further behind.

"Because Brazil has a large and industrially diverse economy, our findings shed light on the effects of increased international trade in other large and diverse economies, including the United States," said Dix-Carneiro.

Standard trade theory predicts a short-term decline in wages and employment growth in regions facing larger tariff reductions, but as workers move to areas and industries with more employment opportunities, earnings differences should equalize. Instead, the authors found that the opposite happens. From 2000 - 2010, workers who were negatively affected by freer trade saw the gap in their earnings (compared to workers in other regions) grow by 300 percent. Earnings and employment growth in regions with more import-competing industries fell behind and did not catch up to other regions in the decades following tariff reductions. The authors found that a lack of worker mobility and the slow movement of capital between geographic regions were the fundamental blockades to adjustment.

"Our approach can be used to identify regions that are least likely to benefit from trade, helping policymakers consider where to target interventions assisting workers in those places," said Kovak. "Further work is needed to determine what interventions are most likely to succeed, and we hope our findings will motivate more research in this area."

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