TRADE LIBERALISATION AND HUMAN CAPITAL ADJUSTMENT

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Abstract

This paper highlights the way in which workers of different age and ability are affected by anticipated and unanticipated trade liberalisations. A two-factor (skilled and unskilled labour), two-sector Heckscher-Ohlin trade model is supplemented with a education sector which uses skilled labour and time to convert unskilled workers into skilled workers. A skilled worker’s income depends on her ability, but all unskilled workers have the same income. Trade liberalisation in a relatively skilled labour abundant country increases the relative skilled wage and induces skill upgrading by the existing workforce. The younger and more able unskilled workers are most likely to upgrade. But not all upgraders are better off as a result of the liberalisation. The older and less able upgraders are likely to lose. For an anticipated liberalisation we show that the preferred upgrading strategies depend on a worker’s ability and that much of the upgrading will take place before the liberalisation. This implies that some workers who would have upgraded had they anticipated the liberalisation will not if it is unanticipated, and that adjustment assistance that applies only to post-liberalisation upgraders will fail to compensate some losers and distort the upgrading decisions of others.

Keywords: International trade, Factor mobility, Labour market adjustment.

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