

International Trade, Technology, and the Skill Premium*

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This Version: February 2012
First Version: October 2008

Abstract

What are the consequences of international trade on income inequality—measured as the relative wage of skilled to unskilled workers, the *skill premium*? To address this question we formulate a multi-country model of international trade that introduces skill intensity differences across firms and sectors and factor endowment differences across countries into an otherwise standard quantitative model of international trade. Parameterized using firm-, sector-, and aggregate-level data, our model can account for a number of features of the data related to differences in skill-intensities across firms within sectors, between- and within-sector factor reallocation, and relative sector-level prices and trade shares. Our model generates large increases in the skill premium in response to reductions in trade costs, especially in open countries and small countries, but not necessarily in those that are skill abundant. Using data generated by our model, we show that standard approaches in the literature underestimate the rise in the skill premium generated by trade cost reductions in almost all countries, especially in skill-scarce countries.

*We thank Francisco Alcalá, Chris Kurz, and especially Marc Muendler and Eric Verhoogen for help with their data. We are grateful to Andrew Atkeson, Arnaud Costinot, Javier Cravino, Jonathan Eaton, Gene Grossman, Oleg Itskhoki, Ellen McGrattan, Andrés Rodríguez-Clare, Esteban Rossi-Hansberg, and Stephen Yeaple for very useful comments. Previous versions of this paper circulated under the names “Globalization, Technology, and the Skill Premium” and “Globalization, Technology, and the Skill Premium: A Quantitative Analysis.”