

Trade, Labour Market Frictions, Unemployment, and the Wage Differential

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Abstract

This research examines the interaction of (de)unionization and trade liberalization in shaping firm productivity, market structure, trade flows, unemployment, and functional distribution (changes in the wage difference and labour income share). It introduces unemployment to the Melitz-Ottaviano model (2008) by considering unionism in the differentiated manufacturing sector and searching frictions in the homogeneous service sector. In the closed economy, we show that unionization has a selection-softening effect, leading to a non-monotonic relationship between unionization and the number of firms and un-employment. In the two-country equilibrium, unilateral unionization in one country gives rise to a selection-softening effect for domestic-only firms and a selection-toughening effect for exporting firms in this country. With international trade, unionization is more likely to increase unemployment relative to autarky. In response to the unilateral unionization, the average wage difference for this country compared to its trading partner country rises if openness to trade is low, but it declines if openness to trade is high. Under unionized labour markets, trade liberalization does not necessarily reduce unemployment, depending on the relative degree of unionization between the two trading countries. In sharp contradiction to the conventional notion, deunionization can increase, rather than decrease, the labour income share of unionized workers, provided that openness to trade is sufficiently high.

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