TRADE AND FRICTIONAL UNEMPLOYMENT IN THE GLOBAL ECONOMY

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Abstract
We develop a multi-country, multi-sector trade model featuring risk-averse workers, labor market frictions, unemployment benefits, and equilibrium unemployment. Trade opening leads to a reduction in unemployment when it simultaneously raises welfare and reallocates labor towards sectors with lower-than-average labor market frictions. We then estimate and calibrate the model using employment data from 31 OECD countries and worldwide trade data. Finally, we quantify the potential unemployment, real wage, and welfare effects of repealing NAFTA and raising bilateral tariffs between the US and Mexico to 20%. This policy would increase unemployment by 2.4% in the US and 48% in Mexico. (JEL: F15, F16, F17, J64)