Labor Market Responses to Trade: Job Creation and Destruction Across Space and Sectors

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Abstract

In an era dominated by globalization and international trade, the impact of trade shocks on employment has become a pressing concern for policymakers and the public. This paper examines the effects of the China trade shock on U.S. local labor markets, focusing on unemployment and its determinants: job finding and job separation rates. Using a shift-share design, I find that U.S. regions exposed to the China trade shock experience significant and persistent increases in unemployment due to lower job finding and higher job separation rates. To explain these outcomes, I propose a dynamic multi-sector, multi-region labor matching model with endogenous job creation and destruction, with a stylized version able to rationalize the relative effects found in the empirical part. The calibrated full model predicts and quantitatively confirms that trade shocks raise unemployment, decrease employment, and increase welfare inequality across the majority of U.S. states. Overall, the China trade shock raises the U.S. unemployment rate by 0.18% and accounts for about 87% of the observed decline in the share of manufacturing employment over working-age population from 2000 to 2007. Despite worsening labor markets, the China shock boosts the overall productivity of the U.S. by 0.16% and improves the overall welfare by 0.04%. I find that the Hosios condition is not enough to deliver constrained efficiency in this model with migration frictions and nontradable goods, hence room for policies. A redistributive corporate tax policy to subsidize the manufacturing sector can improve overall welfare and reduce unemployment while restoring the pre-shock manufacturing employment level.

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