

Author's Accepted Manuscript

International Trade and Quality of Labour

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www.elsevier.com

PII: S1059-0560(16)30362-8
DOI: <http://dx.doi.org/10.1016/j.iref.2017.03.018>
Reference: REVECO1403

To appear in: *International Review of Economics and Finance*

Received date: 15 December 2016
Revised date: 12 March 2017
Accepted date: 13 March 2017

Cite this article as: Sarbajit Chaudhuri and Sugata Marjit, International Trade and Quality of Labour, *International Review of Economics and Finance* <http://dx.doi.org/10.1016/j.iref.2017.03.018>

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International Trade and Quality of Labour*

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This version: March 12, 2017

Abstract: This paper argues that better prospect for exports induces firms to distinguish high quality workers from low quality workers by providing an incentive wage. Thus, trade leads to identification of labour quality, widening the wage gap between the high quality (skilled) and the low quality (unskilled) workers. The results are derived in a model containing both moral hazard and adverse selection problems. We provide a different argument from the ones as available in the existing literature including the standard Shapiro-Stiglitz (1984) shirking model. Finally, the results of the paper have some important policy implications.

Keywords: Quality of labour; incomplete information; incentive contract; international trade; wage gap; Ricardian trade model.

JEL Classification: D86; F16; J31; L15.

* This paper has been revised in the light comments of two anonymous referees of this journal to whom the authors are thankful. The usual disclaimer, however, applies.

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