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Abstract

We construct a North-South product-cycle model of trade with fully-endogenous growth and union wage bargaining. Economic growth is driven by Northern entrepreneurs who conduct R&D to innovate higher quality products. Northern production technologies can leak to the South upon successful imitation. The North has two sectors: a tradeable industrial goods sector (manufacturing) where wages are determined via a bargaining process and a non-tradeable sector (services) where wages are flexible. The South has only a tradeable industrial goods sector where wages are flexible.

We find that unilateral Northern trade liberalization, in the form of lower Northern tariffs on industrial goods, increases the rate of innovation but decreases both the bargained wage in the industrial sector and the flexible wage in the service sector. The wage effects are relative to the Southern wage rate. We also consider a variant of the model with Northern unemployment, driven by a binding minimum wage in the non-tradeable service sector. In this case, Northern tariff cuts decrease the innovation rate and the bargained wage rate. In addition, the Northern unemployment rate increases. The model thus highlights role of labor market institutions in determining the growth and labor market effects of tariff reductions. We also study the effects of unilateral Southern trade liberalization.

Keywords: Schumpeterian growth, product cycle, trade liberalization, labor unions, bargaining power, unemployment

JEL classification: F12, F43, J51, O31, O32

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