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Globalization, Chinese Imports, and Skill Premia
in a Small Open Economy

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Abstract

This paper studies the effect of increased competition from low wage countries on the earnings gap between skilled and unskilled workers by using matched worker-firm micro data covering the total population of workers in private manufacturing firms in Sweden, 1996-2007. Treating Chinese accession into WTO as an exogenous shock to domestic competition, the paper shows that higher Chinese import penetration increases the wage gap between low educated and college educated workers, translating into a rise in wage inequality. Estimations show that the skill wage gap has increased due to a significant increase in the premium for college educated workers. This effect remains even after taking a time trend in the return to college education into account. The effect on high-skilled workers in response to an average of 2.9 percentage point increase in Chinese import penetration is 2.7 percent higher wages. Since real skilled wages have risen about 27 percent in this period, suggesting that rising competition from low-wage countries has contributed to around 10 percent of the increase in skilled wages. Skilled workers appear to be complementary to the goods imported from low-wage countries, and therefore command a higher wage with rising imports from China. Firms may even upgrade their production technologies in response to rising competition from China, which should further increase the demand for and wages of these workers. One of the reasons why wages for non-college workers are not significantly affected by changes in Chinese imports could be due to the institutional setting in Sweden where contracts negotiated with labor unions impose lower limits on wages. The results of the paper differ from previous work by both utilizing a detailed matched employer-employee database and by finding a robust and significant positive effect on the return to college education even after controlling for a time trend in return to education.

Keywords: Chinese Imports, Wage Dynamics, Import Competition, Skill Premium, Return to Education.

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