

The Stolper-Samuelson theorem SS

Meeting 4

SS theorem: intro

- A fall in the relative price of a good will lead to a fall in the return to the factor used most intensively in production of the good, and conversely, to a rise in the return to the other factor
- $\downarrow P \text{ good1} \rightarrow \downarrow \text{Return factor1 (used for good1)} \rightarrow \uparrow \text{Return factor2 (used for good2)}$

SS is based on neoclassical assumptions:

- a world of very few produced goods
- perfect competition between and within countries
- complete factor mobility within countries (but no mobility between countries)
- no transport costs and
- tradability of all goods

Application to labour

- In a model with two factors, say skilled and unskilled labour, as countries reduce trade barriers, the relative prices of skill-intensive goods will rise in skill-rich countries, and fall in skill-poor countries.
- As this happens, SS predict a rise in skilled wages and a fall in unskilled wages in the skill-rich countries.

| | Developed country aka advanced Skill-rich country | Developing country Skill-poor country |
|--------------------------------|--|--|
| Prices of Skill intensive good | ↑ | ↓ |
| Skilled wage | ↑ | |
| Unskilled wage | ↓ | |

Wage inequality

Blue collar workers are less likely to bargain on wages compared to skilled workers.

White collar workers have a higher bargaining power than workers with lower skills.

The Stolper-Samuelson theorem

- Uses the Heckscher-Ohlin model to predict strong links between changing trade prices and wage inequalities
- States that increased trade with developing countries has probably played some part in the widening wage inequalities
- Supports the idea that increasing trade with developing countries has been a major cause of the increasing inequality in certain advanced countries (notably the USA and UK) since 1979

The implications of this model are disturbing for advanced countries

- The current globalisation tendency can be seen as an opening up to increased trade between the skill-rich advanced countries and developing countries.
- While the H-O theory predicts this would benefit GNP in both advanced and developing countries, in the former this would be at the expense of falling unskilled wages and increasing inequality.

Benefits from trade

| | Developing countries | Developed countries |
|----|----------------------|------------------------------|
| HO | + | + |
| SS | + | - |
| | | (because of wage inequality) |

How to mitigate wage inequalities

- Contrary to what Stolper-Samuelson might suggest, governments have considerable power to mitigate rising wage differentials by use of education and training policy to increase workforce skills
- But, Stolper-Samuelson doubts on the popular policy response: to improve education and training