Trade and Variety-Skill Complementarity:

A Simple Theoretical Resolution of Trade-Wage Inequality Anomaly

(Job Market Paper)

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The Stolper-Samuelson theorem predicts that the relative wage of high-skilled to low-skilled labor will increase in the high-skill abundant U.S. but decrease in low-skill abundant Mexico after trade liberalization, while data show that the skill premium began to rise in both countries in the late 1980s. This paper presents a simple theoretical resolution of this "trade-wage inequality anomaly." The resolution is a straightforward application of well-known variety trade models. Intra-industry trade increases the variety of intermediate goods used by the final good. If the varieties and high skill are complements, the skill premium rises in both countries. This linking of intra-industry trade to wage inequality is consistent with evidence. Our numerical experiments show that increased U.S.-Mexican intra-industry trade, which is a small fraction of U.S. GDP, can account for much of the increase in U.S. and Mexican skill premium for a reasonable parameterization of the model. (*JEL* F12, F16)

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